

VISIT...

LANZAROTE
Caliente.COM

UPS DISTRIBUTION



This is your warehouse full of your products from overseas.



But what if your warehouse had wheels?



There — now your products can fly to the store shelves. Look at that, a mobile distribution center.

Find out more at ups.com/whiteboard

WHAT CAN BROWN DO FOR YOU?®



Harvard Business Review

www.hbr.org



May 2007



...page 62

- 62 **Surviving Your New CEO**
Kevin P. Coyne and Edward J. Coyne, Sr.
- 72 **Inner Work Life: Understanding the Subtext of Business Performance**
Teresa M. Amabile and Steven J. Kramer
- 84 **Strategies to Crack Well-Guarded Markets**
David J. Bryce and Jeffrey H. Dyer

96 **Customer Focus**

HBR
Spotlight

- 98 **Silo Busting: How to Execute on the Promise of Customer Focus**
Ranjay Gulati
- 110 **Even Commodities Have Customers**
François M. Jacques

22 **FORETHOUGHT**

37 **HBR CASE STUDY**

- The Dark Side of Customer Analytics**
Thomas H. Davenport and Jeanne G. Harris

51 **FIRST PERSON**

- Back in Fashion: How We're Reviving a British Icon**
Stuart Rose

121 **DIFFERENT VOICE**

- Picking Winners**
A Conversation with MacArthur Fellows Program Director Daniel J. Socolow

128 **BEST PRACTICE**

- The Value Captor's Process: Getting the Most out of Your New Business Ventures**
Rita Gunther McGrath and Thomas Keil

142 **EXECUTIVE SUMMARIES**

148 **PANEL DISCUSSION**

To be better than
the competition,
you can't have them as
your parent company.

BMW 2007

**bmwusa.com
1-800-334-4BMW**



**The Ultimate
Driving Machine®**

It is our firm belief at BMW that remaining independent is essential to who we are. We hold fiercely to this autonomy because we know the day we give it up is the day we will be asked to compromise our ideas. Perhaps not at first, but somewhere down

the line, we would have to give up something that makes our cars great. And to us that's just unthinkable. At BMW ideas are everything. And we make sure great ideas live on to become Ultimate Driving Machines.®



**CREATING BETTER PARMESAN
TAKES DISCRIMINATING TASTE.
PARTICULARLY
ON THE PART OF
THE COW.**

www.cargillcreates.com

©2007 Cargill, Incorporated



Italian cheese makers take pride in Parmigiano Reggiano, a cheese so distinctive that law dictates it come only from select provinces of Italy. Parmigiano Reggiano cheese makers wanted more productivity while maintaining this legendary quality. Cargill brought animal nutrition experts into the process who understood dairy cow productivity. We developed special feeds to supplement the cows' base diet of local grasses and hay. Now the cows give milk that generates better yields of high-quality Parmigiano Reggiano. And there's more of the famed cheese for all to enjoy. This is how Cargill works with customers.

collaborate > create > succeed™



Cargill™

Nourishing Ideas. Nourishing People.™

Features

62 Surviving Your New CEO

Kevin P. Coyne and Edward J. Coyne, Sr.

Your company just hired a new CEO, and you figure that a reorganization—maybe even a few terminations—could be on the way. You're not worried, though: Your solid record and excellent reputation as a senior executive mean you're safe. Right? Wrong.

72 Inner Work Life: Understanding the Subtext of Business Performance

Teresa M. Amabile and Steven J. Kramer

New research shows how business performance is driven by workers' state of mind—and how managers, if they're not careful, can drive both down.

84 Strategies to Crack Well-Guarded Markets

David J. Bryce and Jeffrey H. Dyer

Despite barriers to entry, companies trying to break into highly profitable industries can defy half a century of economic logic and actually make money.

HBR
Spotlight

Customer Focus

96 Introduction

98 Silo Busting: How to Execute on the Promise of Customer Focus

Ranjay Gulati

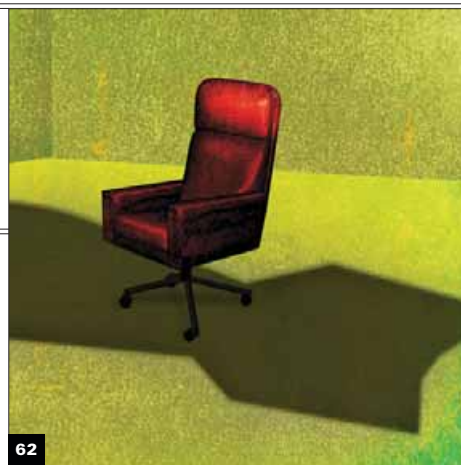
More and more companies claim that they offer solutions—packages of products and services that are hard to copy and can command premium prices. To truly solve customers' problems, however, companies often have to make significant changes to their structures, processes, and mind-sets.

110 Even Commodities Have Customers

François M. Jacques

Who would have thought there'd be so much differentiation opportunity in cement? Someone clever enough to apply marketing's most basic tools, it turns out. If it works for cement, it could work for your commodity business, too.

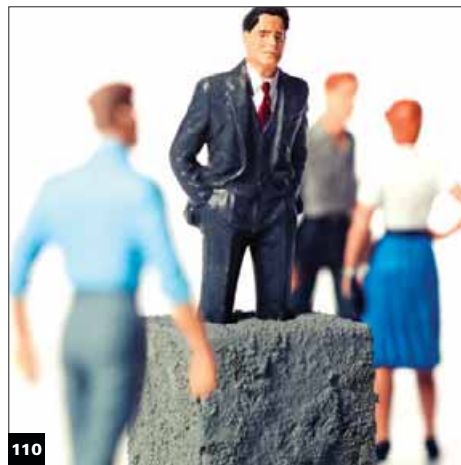
continued on page 8



62



72



110



98



84

Symantec**Vision**2007

June 12-14, 2007 | The Venetian | Las Vegas, Nevada, U.S.A.

The vulnerability of your business

is connected to the enormity of your IT infrastructure

is connected to an accurate assessment of the risks involved

is connected to solutions that manage security, availability, and compliance

is connected to Symantec Global Services for results that shine

from assembly line to the bottom line.

© 2007 Symantec Corporation. All rights reserved. Symantec and the Symantec Logo are registered trademarks of Symantec Corporation.

Manage IT risk and cost across your entire operation with the unmatched expertise of Symantec.

The first step in dealing with IT risk is to quantify it precisely. Our expert assessments quickly give you the necessary input to select the appropriate solution to fit your needs and budget. And once IT risk is mitigated, the cost advantages throughout your enterprise can be dramatic. Realize the potential in your operation with the help of the Global Services team from Symantec. To contact a representative call 1-877-870-5700 or visit symantec.com/confidence

Confidence in a connected world.



Putting Accenture's research to work.

Thomas Cook

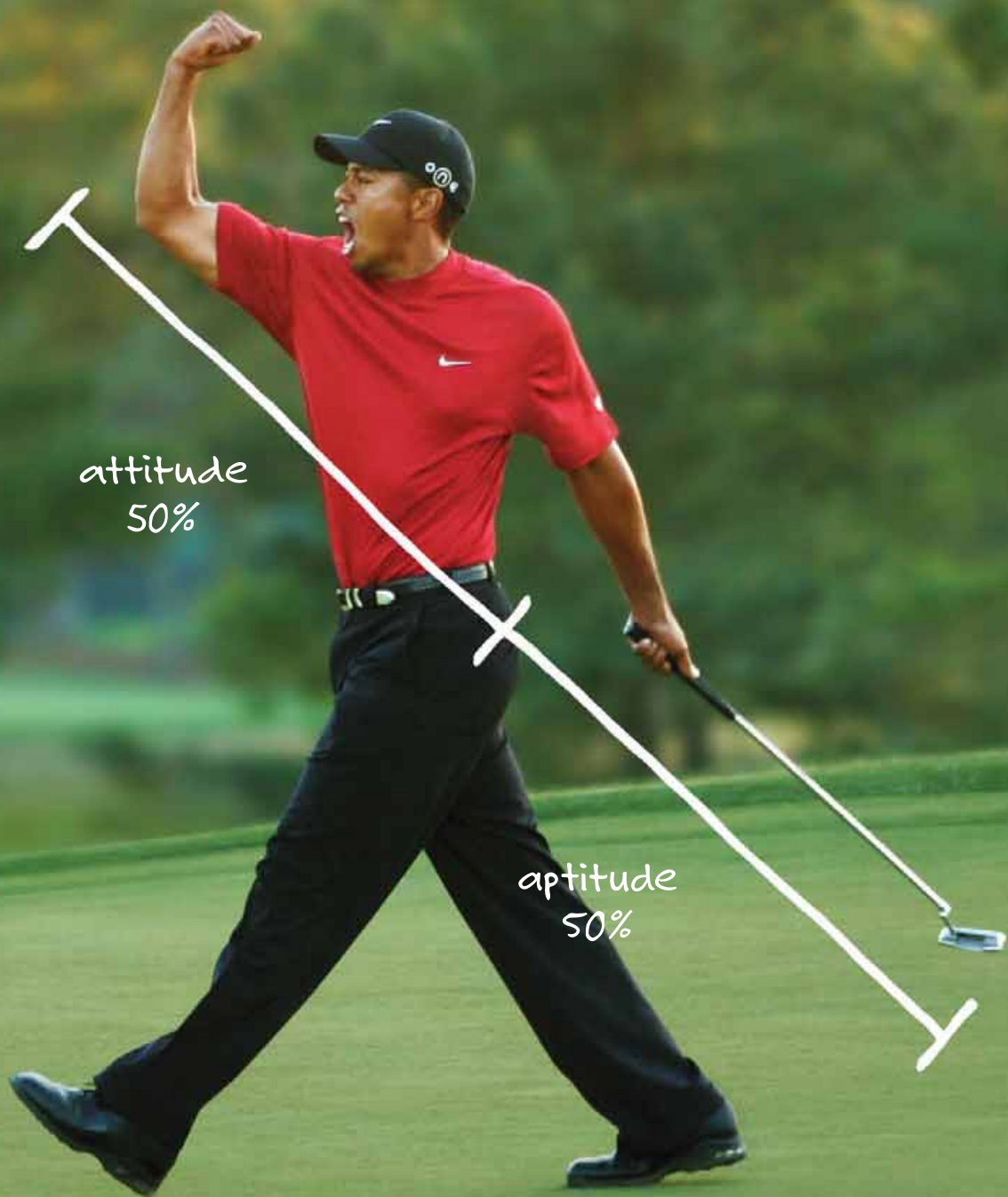
High-performance operations, delivered.

A 163-year-old brand with many owners over the years, Thomas Cook UK & Ireland was a respected but complex decentralized travel services business in need of a return to profitability. In an innovative co-sourcing arrangement with Accenture, the company created a shared services center to consolidate its widely dispersed IT, finance and HR administration operations. Responsibility for strategy and policy was retained by Thomas Cook, with Accenture facilitating operations management. In 16 months, the company removed £140 million in operational costs, helping to achieve an £83 million turnaround, establishing Thomas Cook as a high-performance player in the competitive UK travel business.

Wyeth

High-performance R&D, delivered.

Determined to boost its output of innovative new medicines, Wyeth's research & development leadership teamed with Accenture to reengineer the way the pharmaceutical company discovers new molecular entities and moves them through preclinical development and clinical trials. The companies designed and implemented vast changes to streamline operations and dramatically improve the effectiveness of Wyeth's proven R&D organization. Now, three years into the initiative, the productivity of Wyeth's drug discovery effort has risen 400 percent, early clinical trial cycle times have been cut by 60 percent, and a new high-performance model for outsourcing clinical data management is substantially reducing costs by about 50 percent.



attitude
50%

aptitude
50%

We know what it takes to be a Tiger.

What separates high performers from lesser competitors isn't just talent. It's the way they fuse their capability and mindset. It's what we call performance anatomy and it's one key finding from our groundbreaking research into the world's most successful companies. For an in-depth look at our study of and experience with high performers, visit accenture.com/research

• Consulting • Technology • Outsourcing

**>
accenture**
High performance. Delivered.

Departments

12 COMPANY INDEX

14 FROM THE EDITOR

Secrets of the Workplace

What really happens when there's upheaval in the workplace? Till now, most of what has passed for knowledge about such matters has been anecdotal and most of the advice avuncular. Two fruitful streams of research—one looking at the turmoil that follows the appointment of a new CEO and the other examining the unspoken feelings and perceptions of employees as they go about their everyday business—have replaced guesswork with data and folklore with facts.

22 FORETHOUGHT

Viral-marketing tools can boost traditional mass marketing...Your employees may be too scared to share their best ideas...The bigger the smile the better...Cost accounting is not revenue accounting...What harm, overtime?...What poetry can do for business...New products need to reap higher prices, not just more sales...Who will solve your toughest R&D puzzles?

37 HBR CASE STUDY

The Dark Side of Customer Analytics

Thomas H. Davenport and Jeanne G. Harris

A customer data-sharing deal between two companies could reap easy money for both. But things could get complicated if customers find out how their personal information is *really* being used. How can the companies leverage the data responsibly?

51 FIRST PERSON

Back in Fashion: How We're Reviving a British Icon

Stuart Rose

When retailer Marks & Spencer hired Stuart Rose to turn the company around, he told the board that three things needed to be done right away: improve the product, improve the stores, and improve the service. It was—and still is—that simple.

94 STRATEGIC HUMOR

121 DIFFERENT VOICE

Picking Winners

A Conversation with MacArthur Fellows Program Director Daniel J. Socolow

What can business leaders learn from the organization that confers the storied "genius grants"? For one thing, that exceptional creativity is very hard to find. If you're looking for a way to pack your staff with outstanding talent, you're probably on the wrong track.

128 BEST PRACTICE

The Value Captor's Process: Getting the Most out of Your New Business Ventures

Rita Gunther McGrath and Thomas Keil

It's a mistake to assume that a venture is successful only if it proceeds directly to go and produces payback within two years. Value captors have learned how to systematically mine all the possible benefits of their initiatives—including the failures.

138 LETTERS TO THE EDITOR

Basing corporate social responsibility on long-term profitability represents dangerous and flawed thinking.

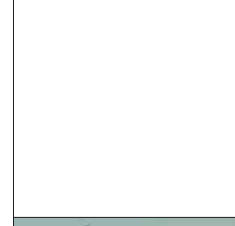
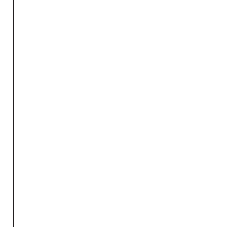
142 EXECUTIVE SUMMARIES

148 PANEL DISCUSSION

The Stages of Learning

Don Moyer

Learning is a lifelong process—you'll never stop climbing the ladder of experience.



LEXUS HAS ONLY ONE PLANT OUTSIDE JAPAN.

When Lexus needed to expand, they sought the same impeccable standards they developed in Japan. They found it here, in Ontario. Ontario fulfilled all of Lexus' prerequisites: our location in the heart of North America and transportation infrastructure linking us to millions of customers; our skilled workforce and tradition of automotive innovation; and our competitive business costs. Since the first RX 330 rolled off the line, the Cambridge, Ontario plant has satisfied all of Lexus' quality demands. In fact, Lexus' parent company, Toyota, will be opening a second Ontario plant in 2008. The Japanese have a word for continuous improvement: kaizen. Now they have another: Ontario. There's no better place in the world to do business.



ONTARIO
CANADA

2ontario.com/quality
1-800-819-8701





GO TO HBR.ORG, AND YOU'LL NOTICE SOME CHANGES. *Harvard Business Review* has rolled out the first stage of its Web site enhancements, the culmination of which will be an entirely revamped site this fall.

1. QUICK ACCESS TO EXECUTIVE SUMMARIES

HBR readers have said in surveys that they like to scan the executive summaries before looking at the articles. Now they can do so more easily, because links to the summaries appear on every page.

2. RELATED ARTICLES

With more than 85 years of publishing history, *Harvard Business Review* has a wealth of material in its archives. To see what else HBR has published on the topic of a given article, consult the "Related Articles" list at the bottom of the screen.

3. A WIDER VIEW

We have reorganized our online content to take full advantage of the screen space, so readers won't have to do as much scrolling to find what they want.

If you have any thoughts about these site changes or suggestions for future efforts, please contact the executive editor of HBR Online, Eric Hellweg, at ehellweg@hbsp.harvard.edu.



THIS MONTH AT HBR.ORG



> GLOBALIZATION RESEARCH

Professor Pankaj Ghemawat (of IESE Business School and Harvard Business School) invites HBR readers to participate in a research survey on globalization and strategy. Participants will receive a free PDF of Ghemawat's 2005 McKinsey Award-winning article, "Regional Strategies for Global Leadership," which discusses how companies can capitalize on regional differences.



> MARKS & SPENCER'S £200 MILLION "ECO-PLAN"

Click on "Back in Fashion: How We're Reviving a British Icon," by M&S CEO Stuart Rose, to link to details about the company's latest "green" efforts.

> HBR PODCAST

Visit our audio section to hear HBR's editors discuss articles on tap for next month.



ALWAYS AT HBR.ORG

SUBSCRIBER ACCESS

If you are a subscriber, you have 12 months' worth of digital back issues at your disposal. Click on any article with a shield next to it, , and you will be prompted to enter your subscriber ID information.

PREMIUM SUBSCRIPTION

A premium subscription to *Harvard Business Review* gives readers access to a searchable archive of more than 2,700 articles. To sign up, click on "Subscribe Today" in the upper-right corner of the home page.

HBR IN OTHER LANGUAGES

Visit "HBR in Other Languages," under "Also in This Issue" on the home page, for information about the 11 licensed translated editions of *Harvard Business Review*.



Only by understanding your needs —————
————— can we provide you with the right solution



Whether in Banking, Insurance, Asset management or Formula 1, the key to success is the same. It's all about taking the right decisions based on the facts and figures. With 115,000 employees in over 50 countries, we are dedicated to delivering tailored financial solutions to you.

INSURANCE · BANKING · ASSET MANAGEMENT

ING 

WWW.ING.COM

Organizations in this issue are indexed to the first page of each article in which they are mentioned. Subsidiaries are listed under their own names.

Adidas	84	L'Oréal	110	Verizon	84
Air Products and Chemicals	128	MacArthur Fellows Program	121	Virgin Drinks	84
Amazon	84	Marks & Spencer	51	Wal-Mart	51, 84
Apple	84	McDonald's	84	Whirlpool	22
Arcadia Group	51	McKinsey	110	World Wrestling Entertainment	84
ASDA	51	Microsoft	84, 128	Zara	51
AstraZeneca	22	Motorola	98, 128		
AT&T	84	National Institute for Occupational Safety and Health	22		
Atari	84	Netflix	84		
Babies "R" Us	84	Next	51		
Bank of America	98	Nike	84		
Bassett Furniture	84	Nintendo	84		
BenQ	98	Nokia	128		
Best Buy	98	Oxygen Media	22		
Blockbuster	84	PayPal	84		
Boeing	22	PepsiCo	84, 98		
The Bombay Company	84	Procter & Gamble	22, 128		
Borders	37	Progressive Insurance	37		
Brady Campaign to Prevent Gun Violence	22	Redbox	84		
Cadbury Schweppes	84	Red Bull	84		
Cemex	110	Reebok	84		
Cingular	84	Saks Fifth Avenue	37		
Cisco Systems	98	Sazaby League	98		
Citigroup	22	Siemens	128		
Clorox	22	Skechers	84		
Coca-Cola	84	Skype	84		
Coinstar	84	Soletron	98		
Colgate-Palmolive	22	Sony	84		
Costco	84	Sprint	84		
Cott	84	Stanford University Medical Center	98		
Design Continuum	84	Starbucks	98		
Deutsche Telekom	128	StoptheNRA	22		
Disney	84, 98	Swiss Re	128		
Dreyer's Grand Ice Cream	98	Target	37, 98		
DuPont	128	Techtron Industries	22		
Dyson James	22	Tesco	51		
Electronic Arts	84	Texas Instruments	128		
Embraer	84	Thomasville Furniture	84		
Ethan Allen	84	3M	128		
Exxon Mobil	128	Topshop	51		
Eyebeam	22	Toys "R" Us	84		
Foot Locker	84	Usana Health Sciences	84		
Fortis	128				
General Electric	98				
General Motors	128				
GNC	84				
Google	84				
Hasbro	84				
Hewlett-Packard	128				
Holcim	110				
Hollywood Video	84				
Hoover	22				
HSBC Bank	51				
Humana	37				
IBM	98, 128				
Ideo	84				
InnoCentive	22				
Intel	128				
International Truck and Engine	22				
Jakks Pacific	84				
JetBlue	84				
JibJab Media	22				
Jim Beam Brands	98				
Jones Lang LaSalle	98				
Kraft Foods	98				
Lafarge	110				
LiveTV	84				

AUTHOR AFFILIATIONS

Accenture	37
Babson College	37
Bain & Company	22
Borders Group	37
Boston College's Carroll School of Management	37
Brigham Young's Marriott School of Management	84
British Fashion Council	51
BuzzFeed	22
Cass Business School	22
Columbia Business School	128
Columbia University	22
ContagiousMedia.org	22
Copenhagen Business School	22
Harrah's Entertainment	37
Harris Allen Group	22
Harvard Business School	22, 62, 72
Helsinki University of Technology	128
HuffingtonPost.com	22
Humana	37
International Truck and Engine	22
Lafarge	110
Land Securities	51
MacArthur Fellows Program	121
Marks & Spencer	51
McKinsey	62, 110
Northwestern University's Feinberg School of Medicine	22
Northwestern University's Kellogg School of Management	98
Penn State's Smeal College of Business	22
Samford University's School of Business	62
TKK Executive School of Business	128
Yale University School of Medicine	22



"I told you to screen my calls."

Roy Delgado

Growt_ & P_oft

The world's most successful companies
have this one figured out.



Sourcing | Applicant Tracking | Skills Testing | Behavioral Assessment | Onboarding | Career Development
Performance Management | Employee Surveys | Succession Planning | HR Analytics | Exit Interviewing

Secrets of the Workplace

IF YOU WORK for a large American company, chances are nearly 50/50 that you will have a new CEO within the next four years. You will also have a new CEO if you work for one of the tens of thousands of companies that are acquired every year. If you're a senior executive – since you're reading HBR, you probably are – a change in command affects you directly. Either you have a new boss, or you are one.

Considering how often turnover at the top happens, it is remarkable how little attention has been paid to the fate of senior managers when a new leader takes over. It isn't pretty, as you will see when you read "Surviving Your New CEO," by Kevin Coyne, who teaches strategy at Harvard Business School and serves as a senior external adviser to McKinsey & Company, and Edward Coyne, an assistant professor at the Samford University School of Business in Birmingham, Alabama. The appointment of a new CEO provokes a lot of change in senior teams, even when the company has been doing well and the new boss is promoted from within—maybe it's the good friend who worked in the office next door to you. If the new CEO is an outsider or if the company is struggling, your odds of surviving lengthen considerably.

Till now, most of what has passed for knowledge about this topic has been anecdotal and most of the advice avuncular. The Coynes, who are father and son, have replaced guesswork with data and folklore with facts. They studied thousands of proxy statements and other materials to determine exactly how much top-team turmoil follows a corner-office change. (More than you think.) They tracked, as much as possible, what happened when the old team looked for new jobs. (That picture isn't pretty, either.) Then the authors set out to discover how an executive can improve the chances of staying on with a new boss—and in the course of that investigation, they learned that an awful lot of supposedly sophisticated executives have some dumb ways of making a first impression.

One of the pleasures of my job—and one of the rewards of reading this magazine – is the chance to learn from people

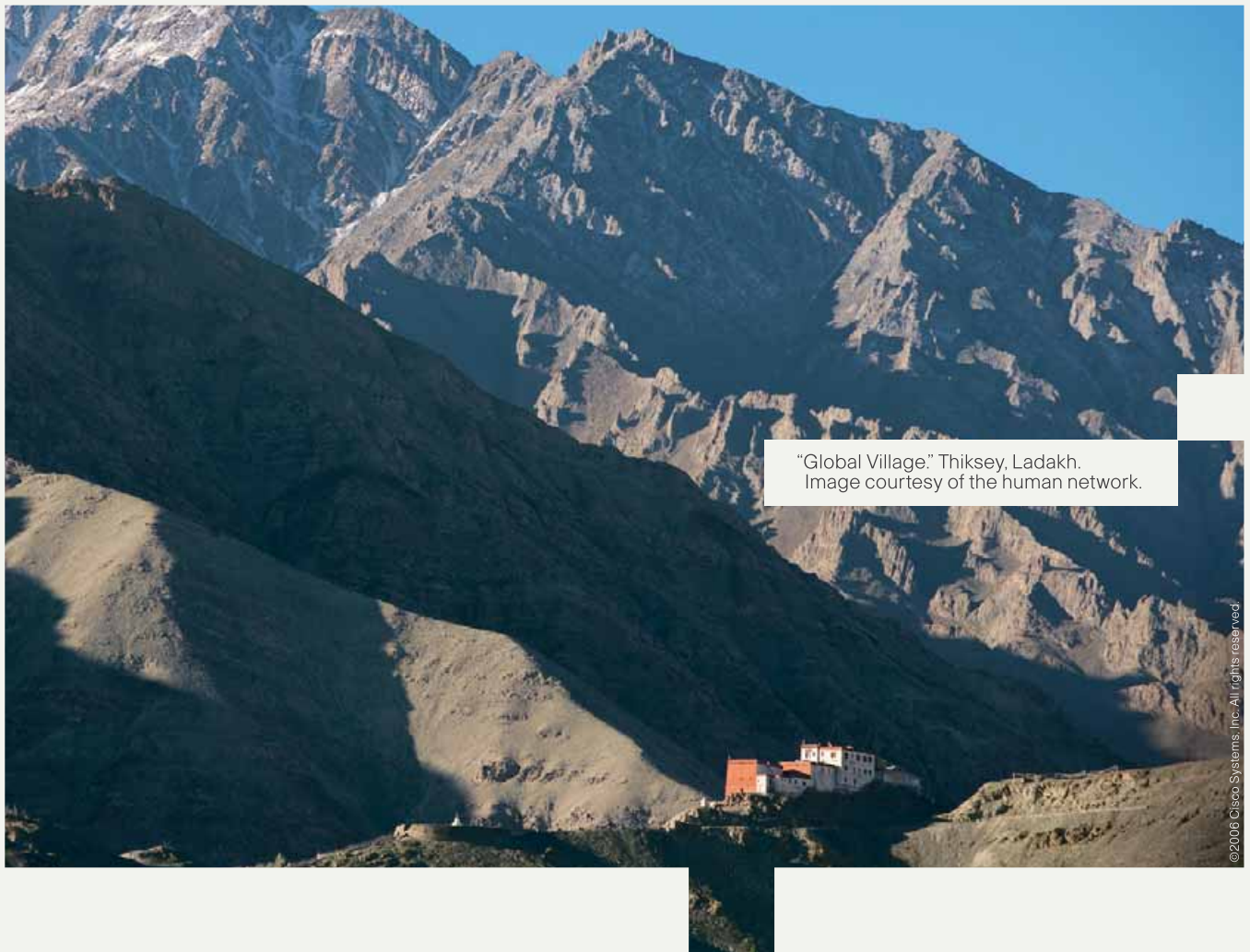


who undertake extraordinary original research. Teresa Amabile and Steven Kramer, a wife and husband team, are two such people, and "Inner Work Life: Understanding the Subtext of Business Performance" is one of those articles. HBS professor Amabile's fruitful, 30-year program of research on creativity at work has previously yielded a theory of creativity and innovation; methods for assessing creativity, motivation, and the work environment; and a set of prescriptions for maintaining and stimulating innovation. The current article focuses on a closely related topic. Our calendars might document the surface

of our work life, but we also have an undocumented inner life. As you and your people go through the day, emotions color perceptions, motivations, and behavior. This inner life is a sort of subtext—a private commentary about the day's events and how we feel about them. I think of it as being rather like the "crawl" that scrolls beneath the main story on CNN or CNBC – a separate but related chain of events – and it is the inner work life that determines whether you had a good day at work or a bad one.

Amabile and Kramer offer us an unprecedented tour of this psychological Atlantis, thanks to a research project in which 238 professionals on 26 project teams kept daily diaries – more than 12,000 entries in all. Here's what Amabile and Kramer say about what they discovered: "It may stun you, if you are a manager, to learn what power you hold. Your behavior as a manager dramatically shapes your employees' inner work lives. But the key levers in your hands for driving motivation and performance may not be the ones you'd suspect."

Thomas A. Stewart



"Global Village." Thiksey, Ladakh.
Image courtesy of the human network.

©2006 Cisco Systems, Inc. All rights reserved.

On the human network, a remote village is included. In a place where books don't usually exist, the Library of Congress can. Technologies such as wireless mesh networking are bringing rural schools and villages to the rest of the world. Leveling playing fields. Flattening geographies. And reinventing everything. The story continues at cisco.com/humannetwork.

welcome to
the human network.





**WHEN MILLIONS OF KIDS ARE WAITING FOR
THE LATEST GAME CONSOLE, AUSTIN CANNON
NEVER HITS THE PAUSE BUTTON.**

Austin Cannon knows that getting the hottest new game consoles to market is all about timing. At any given moment, Austin and his team are able to overnight thousands of shipments to places like Toys "R" Us® Times Square and over 580 other Toys "R" Us locations across the U.S. All on time. All intact. Whether it's Overnight, Ground or International, customer service is back in shipping. www.dhl.com/dedication



>> AUSTIN CANNON

>> DHL PROJECT MANAGER

REGION: U.S.

ASSIGNMENT: DELIVER THE MOST SOUGHT-AFTER SHIPMENTS





©2007 DHL Express USA, Inc. All rights reserved. ©2007 Geoffrey, Inc.

DHL



Boondoggle. Not.

WHARTON EXECUTIVE EDUCATION

We're all business.®

Introducing the Wharton Learning Continuum. From the pre-program coursework to the post-program follow-up, it's no junket. To gain further perspective, download our FREE article series "Wharton on Career Management" at executiveeducation.wharton.upenn.edu. For more information, e-mail execed@wharton.upenn.edu. Call 800.255.3932 (U.S. or Canada) or +1.215.898.1776 (worldwide), and reference HBR.

STRATEGIC THINKING AND MANAGEMENT FOR COMPETITIVE ADVANTAGE

> June 10–15, 2007

September 16–21, 2007

FINANCE AND ACCOUNTING FOR THE NON-FINANCIAL MANAGER

> July 30–August 3, 2007

October 15–19, 2007

EXECUTIVE DEVELOPMENT PROGRAM

> September 9–21, 2007

THE CFO: BECOMING A STRATEGIC PARTNER

> October 28–November 2, 2007



Wharton
UNIVERSITY OF PENNSYLVANIA

EDITOR AND MANAGING DIRECTOR

Thomas A. Stewart

DEPUTY EDITOR AND ASSISTANT MANAGING DIRECTOR

Karen Dillon

EDITORIAL DIRECTOR

Sarah Cliffe

EXECUTIVE EDITOR, HBR ONLINE

Eric Hellweg

ART DIRECTOR

Karen Player

SENIOR EDITORS

David Champion
(Paris)

Diane Coutu

Bronwyn Fryer

Paul Hemp

Julia Kirby

Lew McCreary

Gardiner Morse

M. Ellen Peebles

Steven Prokesch

Anand P. Raman

ASSOCIATE EDITORS

Roberta A. Fusaro

Andrew O'Connell

CONSULTING EDITOR

Bernard Avishai

MANUSCRIPT EDITORS

Christina Bortz

Lisa Burrell

Steven DeMaio

Susan Donovan

Andrea Ovans

Martha Lee Spaulding

EDITOR FOR BUSINESS DEVELOPMENT

John T. Landry

EDITORIAL MANAGER

Kassandra Duane

EDITORIAL COORDINATOR

Rasika Welankiwar

STAFF ASSISTANT

Christine C. Jack

SENIOR PRODUCTION MANAGER

Dana Lissy

EDITORIAL PRODUCTION MANAGER

Christine Wilder

SENIOR ASSOCIATE ART DIRECTOR

Chandra Tallman

SENIOR DESIGNER

Jill Manca

DESIGNER

Lindsay A. Sweeney

EDITORIAL PRODUCTION COORDINATORS

Josette Akresh-

Gonzales

Tisha Clifford

COMMUNICATIONS DIRECTOR

Cathy Olofson

COMMUNICATIONS ASSOCIATE

Siobhan C. Ford

CONTRIBUTING STAFF

Kaajal S. Asher

Lilith Z.C. Fondulas

Amy L. Halliday

Vernon Marchal

Annie Noonan

Eileen Roche

Annette Trivette

Debbie White

A NOTE TO READERS

The views expressed in articles are the authors' and not necessarily those of *Harvard Business Review*, Harvard Business School, or Harvard University. Authors may have consulting or other business relationships with the companies they discuss.

SUBMISSIONS

We encourage prospective authors to follow HBR's "Guidelines for Authors" before submitting manuscripts. To obtain a copy, please go to our Web site at www.hbr.org; write to The Editor, *Harvard Business Review*, 60 Harvard Way, Boston, MA 02163; or send e-mail to hbr_editorial@hbsp.harvard.edu. Unsolicited manuscripts will be returned only if accompanied by a self-addressed stamped envelope.

EDITORIAL OFFICES

60 Harvard Way, Boston, MA 02163
617-783-7410; fax: 617-783-7493
www.hbr.org

**Volume 85, Number 5
May 2007**

Printed in the U.S.A.

**CONSUMER
MARKETING DIRECTOR**
John Titus

**CIRCULATION
DIRECTOR**
Bruce W. Rhodes

**BUSINESS
MANAGER**
Adrienne M. Spelker

**RETENTION
MARKETING MANAGER**
Christine Chapman

**CIRCULATION
FULFILLMENT
MANAGER**
Greg Daly

MARKETING MANAGER
Nicole Costa

ASSOCIATE PUBLISHER
Alex Clemente

**WORLDWIDE
ADVERTISING
SALES MARKETING
DIRECTOR**
Marisa Maurer

**MARKETING
AND RESEARCH
MANAGER**
Jessica Ochoa

**ADVERTISING
PRODUCTION
MANAGER**
Catharine-Mary
Donovan

**MARKETING AND
PROMOTIONS
COORDINATOR**
Jackie D'Alessio

**ASSISTANT
FULFILLMENT
MANAGER**
Danielle Weber

WORLDWIDE ADVERTISING OFFICES

New York Maria A. Beacom
Lisa Carr
Denise Clouse
James H. Patten
Craig Catalano
(Online Sales Director)
75 Rockefeller Plaza
15th Floor
New York, NY 10019
212-872-9280
fax: 212-956-0933

Atlanta 404-256-3800
Boston 978-287-5400
Chicago 312-575-1100
Dallas 214-521-6116
Detroit 248-524-9000
Los Angeles 323-467-5906
San Francisco 415-986-7762

Australia 612-9252-3476
France 33-01-4643-0066
Hong Kong 852-237-52311
India 91-11-4353-0811
Japan 81-03-3541-4166
UAE 971-4-228-7708
United Kingdom 44-20-7833-3733

For all other inquiries,
please call 212-872-9280.

For advertising contact information,
please visit our Web site at
www.hbradsales.com.

SUBSCRIPTION SERVICE INFORMATION

U.S. AND CANADA
800-274-3214; fax: 813-354-3467
Rates per year: U.S., \$119; Canada, U.S.\$139

INTERNATIONAL
31-20-4874465; fax: 31-20-4874412
Rates per year: U.S.\$165; Mexico, U.S.\$139

SUBSCRIBE ONLINE
www.hbr.org

REPRODUCTION

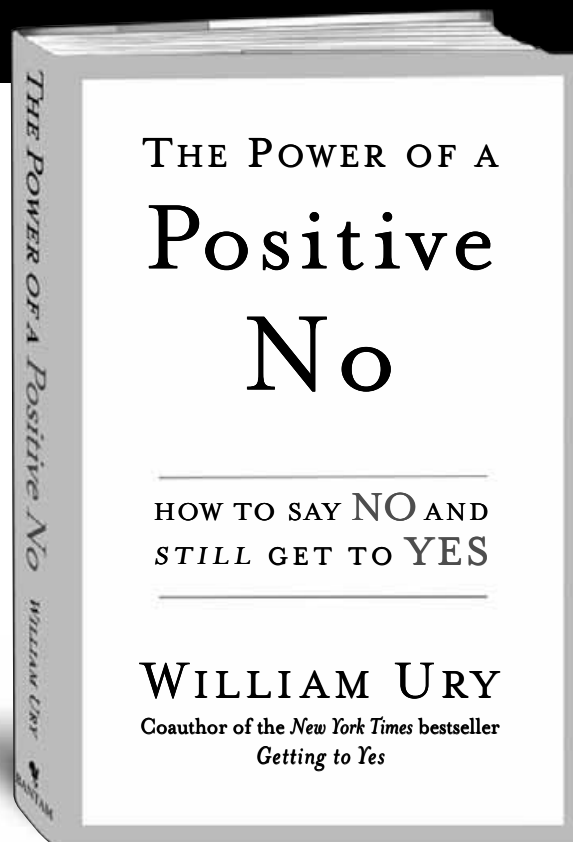
Copyright © 2007 Harvard Business School
Publishing Corporation. All rights reserved.
No part of this publication may be reproduced
or transmitted in any form or by any means,
electronic or mechanical, including photocopy,
recording, or any information storage and
retrieval system, without written permission.

From the coauthor of the bestselling *Getting to Yes*
and author of *Getting Past No*

BE POSITIVE
about what you want.

BE POSITIVE
about what you need.

Be able to **SAY NO.**



"Ury teaches us how to say NO—with grace and effect—so that we might create an even better YES."

—Jim Collins, author of *Good To Great*

"Most of us say YES when we really want to say NO, in both our professional and private lives. Bill Ury generously provides us with insights and techniques to turn this malady into win-win solutions."

—John Naisbitt, author of *Megatrends*



© Carl Studha

A world renowned negotiator, mediator and bestselling author, WILLIAM URY directs the Global Negotiation Project at Harvard. He has worked with conflicts ranging from corporate mergers to ethnic wars in the Middle East.

www.williamury.com



Bantam Also available in Audio and eBook editions from Random House

**There are 193 countries in the world.
None of them are energy independent.**

So who's holding whom over a barrel?



Global Oil Flows



The fact is, the vast majority of countries rely on the few energy-producing nations that won the geological lottery, blessing them with abundant hydrocarbons. And yet, even regions with plenty of raw resources import some form of energy. Saudi Arabia, for example, the world's largest oil exporter, imports refined petroleum products like gasoline.

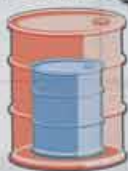
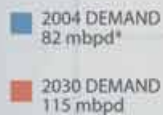
So if energy independence is an unrealistic goal, how does everyone get the fuel they need, especially in a world of rising demand, supply disruptions, natural disasters, and unstable regimes?

True global energy security will be a result of cooperation and engagement, not isolationism. When investment and expertise are allowed to flow freely across borders, the engine of innovation is ignited, prosperity is fueled and the energy available to everyone increases. At the same time, balancing the needs of producers and consumers is as crucial as increasing supply and curbing demand. Only then will the world enjoy energy peace-of-mind.

Succeeding in securing energy for everyone doesn't have to come at the expense of anyone. Once we all start to think differently about energy, then we can truly make this promise a reality.

willyoujoinus.com

Projected Global Oil Demand



*Source: International Energy Agency
million barrels per day

OBJECTIVES EFFICIENCIES

ENERGY IMPORTS BY OIL EXPORTING COUNTRIES

	GASOLINE	ELECTRICITY	NATURAL GAS	COAL
Saudi Arabia				
Russia				
Norway				
UAE				
Nigeria				

Source: Energy Information Administration

WHAT NEEDS TO BE DONE

- DIVERSIFY ENERGY SUPPLIES
- FIND MORE TRADITIONAL FUELS
- DEVELOP ALTERNATIVES AND RENEWABLES
- FOSTER OPEN MARKETS & TRANSPARENCY
- ENCOURAGE CONSERVATION/ENERGY EFFICIENCY

⚠ Chevron Steps Taken:

- Investing over \$15 billion a year to bring energy to market.
- Developing energy through partnerships in 26 countries.
- Committing hundreds of millions annually to alternative and renewable energies to diversify supply.
- Since 1992, have made our own energy go further by increasing our efficiency by 24%.



Human energy™

forethought

A survey of ideas, trends, people, and practices on the business horizon



GRIST

Viral Marketing for the Real World

by Duncan J. Watts and Jonah Peretti

Viral marketing has generated a lot of excitement recently, in part because it seems like the ultimate free lunch: Pick some small number of people to seed your idea, product, or message; get it to go viral; and then watch while it spreads effortlessly to reach millions. Unfortunately, for every high-profile example of a successful viral product—FlashMobs, the Star Wars Kid, or JibJab’s 2004 election spoof—there are many more attempts that fail. Reliably designing messages to exhibit viral properties is extremely difficult, it turns out, as is predicting which particular individuals will be responsible

for spreading them. (See Duncan Watts’s February 2007 HBR List item, “The Accidental Influentials.”)

Fortunately, it is possible for companies to benefit from the insights of viral marketing while avoiding its most serious pitfalls. We propose an approach called *big-seed* marketing, which combines viral-marketing tools with old-fashioned mass media in a way that yields far more predictable results than “purely” viral approaches like word-of-mouth marketing.

The standard viral-marketing model is based on an analogy with the spread of infectious disease. It assumes that one

starts with a seed of individuals who spread a message by infecting their friends, where the expected number of new infectious people generated by each existing one is called the “reproduction rate,” or R . When R is greater than 1, each person who gets the message will, on average, spread it to more than one additional person, who then does the same thing, and so on, leading to exponential growth in the number of people who receive it—an epidemic. By contrast, viral messages with an R of less than 1 are generally considered failures. That’s because purely viral campaigns, like dis-

Phil Marden

ease outbreaks, typically start with a small number of seed cases and quickly burn themselves out unless their R exceeds the epidemic threshold, or tipping point, of 1.

There is an important flaw in the epidemic analogy, however: Companies, unlike diseases, can use standard advertising methods to create potentially enormous seeds. If the initial seed is big enough, then even if R is less than 1, the burnout process will persist for multiple generations, thereby reaching many additional people. By providing social-sharing tools that are easy to use, moreover, marketers can reliably increase the reproduction rate of their message—an important point, as even small increases in R can dramatically increase the number of additional cases.

Imagine, for example, that an advertising firm makes a standard ad buy on the Web, or directs TV viewers to a Web site, or uses an e-mail list to contact potential consumers directly. Regardless of the method used, the campaign will yield some large number, N , of conversions—people who are sufficiently interested to click on the Web ad or embedded link. Traditionally, that's all it would be expected to achieve, but imagine now that these N viewers can also share the ad easily with anyone else. In other words, what would previously have been the entire audience for the message also becomes the big seed for a viral campaign in which the newly added people can forward the message to their friends, who may forward it to their friends in turn, and so on.

Allowing this process to proceed indefinitely, and assuming a constant reproduction rate less than 1, some simple math (details of which are available at <http://cdg.columbia.edu/cdg/papers>) reveals that the final number reached will be approximately $N + (1 - R)$. So if, for example, some campaign exhibited a reproduction rate of 0.5, meaning that each generation is half the size of the previous

one, then an initial seed of 10,000 people would pass it to 5,000 new recipients, and those 5,000 would pass it to a further 2,500, and so on, eventually reaching a total of 20,000 people—twice the number that would have been reached by the traditional campaign.

In the past two years, a number of organizations have effectively implemented big-seed campaigns using open-source software called ForwardTrack, developed by Michael Frumin of the media art non-profit Eyebeam and designed to encourage people to forward messages to their friends. None of the campaigns that used ForwardTrack succeeded in tipping—that is, consistently exhibiting a reproduction rate greater than 1—but by starting out with large mailing lists, all the campaigns reached an impressive number of additional people.

For example, a campaign called Tom's Petition—an appeal for gun control launched in 2004 by StoptheNRA and the Brady Campaign—exhibited a reproduction rate of 0.58, meaning that ForwardTrack more than doubled the size of the initial 22,582-member seed. Stimulated by the success of Tom's Petition, Procter & Gamble subsequently incorporated ForwardTrack into a viral campaign to promote Tide Coldwater as an energy-efficient alternative to regular detergents. This campaign registered a much lower reproduction rate of 0.041 but was initiated with such a large seed—over 900,000—that it still reached some 40,000 more individuals than it would have without the forwarding capability. And a campaign run by Oxygen Network, in which Oxygen agreed to donate \$1 for every participant (up to \$25,000) to Hurricane Katrina relief, exhibited the highest reproduction rate we have seen to date—0.769—reaching an additional 23,544 participants beyond the initial seed of 7,064.

Although our notion of big-seed marketing lacks the mystique of truly viral marketing, it is straightforward to imple-

ment and can reliably improve advertising yields at low cost. Equally important, because big-seed marketing harnesses the power of large numbers of ordinary people, its success does not depend on influentials or on any other special individuals; thus, managers can dispense with the probably fruitless exercise of predicting how, or through whom, contagious ideas will spread.

Duncan J. Watts (djw24@columbia.edu) is a professor of sociology at Columbia University, in New York, where he directs the Collective Dynamics Group. He is the author of *Six Degrees: The Science of a Connected Age* (Norton, 2003). **Jonah Peretti** (jonah@buzzfeed.com) is a founding partner of the Huffington Post, BuzzFeed, and Contagious Media.org.

Reprint F0705A

ORGANIZATIONAL BEHAVIOR

Why Employees Are Afraid to Speak

by James R. Detert and Amy C. Edmondson

What would you think if you overheard an employee confiding in another, "If I tell the director...what customers are saying, my career will be shot"? We actually heard this, verbatim, in the course of our research on communication in a leading high-technology corporation. Our study suggests that this type of self-censorship is common, from the rank and file right up through senior management.

We set out to systematically identify the factors that cause employees to bring ideas to their bosses—or withhold them—by interviewing nearly 200 individuals from all levels and functions of the company. The firm had many formal mechanisms, such as an ombudsperson and grievance procedures, for encouraging people to speak up about serious problems, yet half the employee respondents in a recent culture survey had revealed that they felt it was *not* "safe to

speak up” or challenge traditional ways of doing things. What they were most reticent to talk about were not problems but rather creative ideas for improving products, processes, or performance.

Why? In a phrase, self-preservation. While it’s obvious why employees fear bringing up certain issues, such as whistleblowing, we found the innate protective instinct so powerful that it also inhibited speech that clearly would have been intended to help the organization. In our interviews, the perceived risks of speaking up felt very personal and immediate

to employees, whereas the possible future benefit to the organization from sharing their ideas was uncertain. So people often instinctively played it safe by keeping quiet. Their frequent conclusion seemed to be, “When in doubt, keep your mouth shut.”

Sometimes, employees told us they feared speaking up because managers had been genuinely hostile about past suggestions, but this was relatively rare. More often, they were inhibited by broad, often vague, perceptions about the work environment. A culture of collective myths proved chilling—for example, sto-

ries of individuals who had said something in a public venue and then, as one R&D director put it, were “suddenly gone from the company.”

Implicit, seemingly untested assumptions also led to silence. Many people reported withholding input from a person higher up in the corporate hierarchy because they believed (without any evidence) that the superior felt ownership of the project, process, or issue in question and would resent suggestions that implied a need for change. Employees also believed (again without direct experience) that their bosses would feel betrayed if constructive ideas for change were offered when more-senior leaders were present or that their bosses would feel embarrassed to be shown up by a subordinate in front of other subordinates.

Our findings suggest that encouraging speech, therefore, isn’t simply a matter of removing obvious barriers, such as a volatile leader or the threat of a summary dismissal (though that would help). Nor is it a matter of putting formal systems in place, like hotlines and suggestion boxes. Making employees feel safe enough to contribute fully requires deep cultural change that alters how they understand the likely costs (personal and immediate) versus benefits (organizational and future) of speaking up.

To reduce the costs, leaders must explicitly invite and acknowledge others’ ideas (this does not mean they must always implement them). Executives also must actively challenge the myths and assumptions that reinforce silence. They might, for example, point out publicly that, contrary to common belief, suggestions should *not* be offered privately to save the boss’s face—that ideas are most helpful when they’re openly discussed and other people can help develop them.

Employees might also contribute more if they could balance the untested, intangible costs they’ve been assuming against rewards that went beyond personal acknowledgment of speaking up—that is, to something tangible. One possibility would be for managers to tailor their reward systems so that employees share more directly in the cost savings or



CUSTOMER RELATIONS

Service with a Very Big Smile

The bigger the employee’s smile, the happier the customer. That’s the conclusion of new research from Bowling Green State and Penn State universities.

With the help of trained observers, Patricia Barger and Alicia Grandey followed 173 encounters between customers and employees in coffee shops, scoring the employees’ “smile strength” on a scale from “absent” to “maximal” (which features exposed teeth) at various points during the transaction. The researchers then intercepted the customers and asked them about their service experience. Indeed, the bigger the employee’s smile, the more likely customers were to view that person as competent and the encounter—averaging just two minutes—as satisfying.

But requiring employees to smile can backfire, these and other researchers warn. Studies have shown that forcing workers to act friendly when they don’t feel friendly can lead to job burnout and depression. Forced smiles also tend to look phony, and ample research suggests that customers know, and don’t appreciate, a fake when they see one.

If managers want employees to deliver service with a smile, they can do better than simply mandate it. They could create an environment that encourages genuine smiles and, Barger and Grandey suggest, consider including “a measure of positive emotional expressivity in their employee selection system”—which, loosely translated, means “hire happy people.”

Reprint F0705C

revenue streams they help create by volunteering ideas.

James R. Detert (jdetert@psu.edu) is an assistant professor of management at Pennsylvania State's Smeal College of Business, in University Park. **Amy C. Edmondson** (aedmondson@hbs.edu) is the Novartis Professor of Leadership and Management at Harvard Business School, in Boston.

Reprint F0705B

ACCOUNTING

So You Think You Understand Revenues

by Robert Shaw and Vincent-Wayne Mitchell

Revenue is one of the most misunderstood, mismanaged, and neglected measures in business. Consequently, many executives still rely on gut feel, rather than on hard data, to make revenue decisions—often destroying value in the process. We've seen this happen in the dozens of companies we've studied.

Consider the short shrift revenue gets on accounting reports, and the fallout that can result. In a typical weekly or monthly report, for every revenue inflow there are very many more figures on costs, assets, and liabilities. What's more, it's not uncommon to see as the only explanation

for revenue entries such vague notations as "negative consumer attitudes in our sector" or "disappointing retail support" or "increasing competitor activity."

Comments like those are so general that the managers reacting to them can miss the true sources of revenue variances and end up at cross-purposes with one another. An advertising campaign intended to combat negative attitudes instead merely raises consumer expectations and increases dissatisfaction. A price promotion inspired by the pursuit of "retail support" undermines the premium positioning of the brand and erodes profits. A line extension or package redesign, in response to "competitor activity," only increases costs and cannibalizes sales revenues from the current product range.

You may think that your company, at least, has a handle on revenue basics. But ask yourself these questions: How much does it cost to drive up revenues in your firm by 1%? Which factors—advertising, sales promotions, direct marketing, product innovation—have the biggest effect on revenue growth? If no one can answer in detail, your company lacks basic revenue numeracy.

To understand and manage revenues, companies need a solid grasp of three types of revenue numbers. *Status* numbers tell managers about the sources and size of revenues for each product, cus-

tomers, and sales team. *Response* data describe how revenues rise or fall in response to changes in such factors as price, product features, or advertising. *Limit* data demarcate the limits on demand for products when consumer appetites become satiated, fashions change, or spending power is exhausted.

Companies often assume that the armies of accountants and sophisticated technologies they bring to bear on costs can also illuminate their revenues. But revenues and costs behave fundamentally differently. Costs are active; they directly cause future effects. The relationship of volume to cost of goods is generally linear, and most management accountants tend to use linear equations in calculating cost-volume relationships.

In contrast, revenues are the passive (and often indirect) result of past activity, so understanding them involves looking back in time at the many events that influenced current sales and the nonlinear relationships that govern them. For example, an initial 10% increase in spending on marketing may drive only a 1% increase in revenue, and continued 10% increases will not necessarily yield subsequent 1% increases. When diminishing returns come into play, the nonlinear shape of the investment-versus-revenue graph—the saturation curve—is critical in determining the ideal amount to spend to maximize profits.

To fully understand their revenues, companies should recruit skilled financial-modeling and econometrics specialists. Chances are this capability doesn't reside in-house. Don't give the analysis to someone who lacks specific experience in revenue accounting—and expect to pay a salary commensurate with experience, namely six figures. Just as important, train board members, as well as senior and middle managers, in the basics of revenue measures. Your new modeling specialists can deliver detailed revenue reports, but the people who make strategy must know how to use them.

Robert Shaw (shaw@vbm.com) is a visiting professor, and **Vincent-Wayne Mitchell** (v.mitchell@city.ac.uk) is a professor of consumer marketing, at the Cass Business School, in London.

Reprint F0705D



OPERATIONS

How Risky Is Overtime, Really?

by Harris Allen and William Bunn, MD

Limits on overtime hamper many European and U.S. manufacturers in their efforts to compete effectively against low-wage overseas companies. But our empirical work with International Truck and Engine (ITEC) suggests that across-the-board limitations on the length of the workweek are too simplistic.

Such limits are based on the assertion that long work hours are harmful to employees' health and lead to higher rates of injury and illness. This argument—supported by studies done in Europe, Japan, and the United States—has fueled policies like the Working Time Directive, passed by the European Union in 1993, which set up blanket guidelines for worker hours (manifested in France, for example, in legislation setting the maximum workweek at 35 hours). This argument has also provided context for labor

talks in the U.S., where overtime is often a point of contention.

But our research indicates that only certain types of employees doing certain types of work in certain work environments are at higher risk of illness, injury, or reduced productivity—and only at certain levels of long hours. It also indicates that policies like the Working Time Directive are missing a bigger point: Factors already in play before the first hour of work—for example, prior health—are far better predictors of illness, injury, and impaired on-the-job performance than workweek length. Companies can probably be more effective in boosting employee health and productivity by promoting better health management, disease prevention, and early detection than by limiting hours.

Like many heavy manufacturers, ITEC is most cost-efficient when employees can work more hours than the standard workweek. Overtime helps the company limit labor costs and respond to the cyclical demand for trucks and engines. At the time of the study, in 2001, company policy strongly encouraged workers to put in extra hours, and the average workweek was 43 hours. But workers' compensation and disability costs were high, and the company's absenteeism rate was above the industry average.

So ITEC formed a team to evaluate the impact of overtime. The team, which included union and National Institute for Occupational Safety and Health expertise and was led by an independent consultant, sought to find a balance between the benefits of overtime and its potential negatives—greater risk of injury and illness, more paid time off for absenteeism, declines in on-the-job performance (presenteeism), and escalating health costs. The team analyzed a preexisting database of employees, sorting people by number of hours worked per week and examining their health, safety, and productivity as reflected in claims and on surveys.

For workers who put in 60 or more hours, we did find a higher rate of workers' compensation claims among hourly (primarily female) workers and more new musculoskeletal injuries and illnesses among older salaried employees. But

those instances were the exception.

Workers with other demographic characteristics in the 60-plus-hour group did not show these risks. Moreover, employees working fewer overtime hours (41 to 59 hours per week total) were no more likely to report declines in mental or physical health, impaired performance on the job, or work-related injuries or illness than employees working 40 hours. A person's underlying health, demographic profile, and compensation type (hourly versus salaried) were far more important than workweek length in predicting the likelihood of an adverse outcome. (For details on the study, see Harris Allen, Thomas Slavin, and William Bunn, "Do Long Work-hours Impact Health, Safety, and Productivity at a Heavy Manufacturer," in the February 2007 issue of the *Journal of Occupational and Environmental Medicine*.)

Previous studies haven't uncovered such distinctions, perhaps because they've been based on the hypothesis that *all* workers are *equally* susceptible to progressively greater levels of injury and illness as their hours increase beyond 40. More careful studies are needed to confirm our hypothesis that different types of employees have different levels of risk in different jobs. And further research is needed on the effect of such factors as demographics and prior health.

Our work suggests that restrictions like those in the Working Time Directive may be too blunt and unnecessarily obstruct companies as they compete. The vast majority of employees may be able to work longer hours without jeopardizing their health, productivity, or safety. That means, potentially, more output and greater profitability per employee.

Harris Allen (harris@harrisallengroup.com) is the principal of the Harris Allen Group, a consulting firm based in Brookline, Massachusetts, and a lecturer in health and productivity at Yale University's School of Medicine. **William Bunn, MD** (william.bunn@nav-international.com) is the vice president for health, safety, security, and productivity at International Truck and Engine, in Warrenville, Illinois, and a professor at Northwestern University's Feinberg School of Medicine.

Reprint F0705E





Your industry is changing.
Your competitors are changing.
Your customers are changing.
To improve the value of your stock,
your business portfolio has to change, too.
So, who's going to help you think that through?

winningsolutions.ml.com

©2007 Merrill Lynch & Co., Inc.



Merrill Lynch

Global Markets & Investment Banking Group

Conversation

POET DAVID WHYTE ON CONVERSATIONAL LEADERSHIP

A Larger Language for Business



David Whyte has pushed executives at Astra-Zeneca, Boeing, Citigroup, and a host of other companies to hold the conversations they and their employees most need to have. How?

Through poetry. In workshops and retreats, he recites and reflects on classic and contemporary works, including his own, using images and ideas from the poems to fuel discussions about such challenges as fostering creativity, engagement, and social responsibility. We recently spoke with Whyte about how poetry begets courageous conversation and, in turn, better leadership.

How did you come to bring business and poetry together?

I launched myself as a full-time poet in 1986; soon after, I was approached by a gentleman at the end of a speech I had given. In best American fashion, he said, “We have to hire you,” and in best Irish-English fashion, I asked, “For what?” He persisted, saying, “The language we have in the corporate world is far too small for the territory of relationship and collaboration we’ve entered.” For a poet, that was an intriguing invitation. A poet’s work is all about creating a language big enough to represent both the world you inhabit and the next, larger world that awaits you.

Initially, I was afraid I would be asked to compromise my work, but as it turned out, executives only pushed me further to elaborate on the themes I’d begun to explore. Good poetry can open up areas of everyday business life that remain impervious to the jargon we have created to describe it. Executives are hungry for this larger language.

How can poetry help people become better leaders?

Through the insight it provides. Of course, you don’t go to Wordsworth’s *Prelude* and expect a few good management maxims to come out of it. The poem has bigger fish to fry than whether your organization succeeds or not, but it can cast a brilliant light on the shadowed micro-world of the workplace.

Consider Wordsworth’s phrase “I made no vows, but vows/Were then made for me.” It speaks to the phenomenon that whatever project, plan, or career you commit to,

there will always be a deeper dynamic you discover inside, a promise larger than your original conception that in effect makes vows on your behalf and invites you to find a different kind of courage than you first intended.

Poetry is a way of getting at the phenomenology of conversation—that is, what happens along the way when you’re trying to have a real meeting with something other than yourself: a meeting with your customers, with your colleagues, or with a new field of endeavor. It could also be a conversation with yourself about the greater dimensions of your vocation. Good poets throughout history have looked at almost every stage of the process of creative confrontation. Dante is brilliant on the experience of losing your sense of direction but finding something else in that darkness far more precious: waking, as he said, “in a dark wood where the true way was wholly lost.”

What makes a conversation real?

A real conversation is one that, no matter how slowly, helps you make sense of the world around you. It can tackle great universal questions, or it can be about your work group’s puzzling lack of respect for you or why a division of your company is refusing to go in a previously agreed-upon direction. At the executive and managerial levels, work is almost always conversation in one form or another, and yet we spend almost no time apprenticing ourselves to the disciplines necessary for holding real exchanges. That’s partly because they involve a great deal of self-knowledge and a willingness to study how human beings try to belong—skills we hope our strategic abilities will help us get by without.

The temptation is to say, “I’d much rather inhabit the 5% of reality where I’m in control than enter this 95% where I don’t know what the hell is going on.” But a conversational approach makes work less stressful, not more so. It means leaders don’t have to try to be paragons of perfection. My work has executives asking, in many areas of their lives, personal and professional: “What is the courageous conversation I am not having but need to have to take the next step?”

—Lisa Burrell

Reprint F0705F

© 2006 Acura. Acura, MDX and Super Handling All-Wheel Drive are trademarks of Honda Motor Co., Ltd.



IT'S AN ARRIVAL. IT'S A DEPARTURE.



Introducing the all-new Acura MDX. It makes a striking entrance. And with 300 hp and Super Handling All-Wheel Drive™, it also makes a quick exit. The seven-passenger Acura MDX. Technology takes it to a whole new place. To learn more, call 1-800-To-Acura or visit acura.com.



INNOVATION

Higher Net Price—Or Bust

by Paul Calthrop

Innovative companies that become irrelevant sometimes get that way by misdefining incremental innovation itself. In carelessly defining it as an improvement that leads to higher sales, they overlook a crucial measure when extending a line of products—net price per equivalent unit—that must continue to rise if a company is to avoid the slippery slope.

Net price per equivalent unit is the inflation-adjusted price charged to whoever buys directly from the company—consumers, for instance, or distributors. It is an average, weighted by the number of units sold at each price, that takes into account any deals or discounts. It is expressed in relation to a standard unit (for a candy bar, the unit might be a certain weight of chocolate) so that it can be tracked over time.

If that number is higher than the net price for the previous version of the product, the firm is on the right trajectory. If it is lower, the business may be headed for

trouble. Lower pricing may be a viable strategy for entering a new market or launching a breakthrough technology; otherwise, it points the way toward commoditization, which inevitably undermines the firm's prospects of achieving sustainable revenue and profit growth.

Most companies think they've beaten commoditization if each successive generation of product brings in more total revenue than the last generation did. But they haven't. No line extension project should take up space in the pipeline if it does not promise to yield a higher equivalent net price.

A few years ago, Clorox decreased the number of projects in its innovation pipeline by 40% to focus on those that would promise to be bigger hits, and it increased the value of those projects by 50% with products like the Clorox Bleach Pen, the Toilet Wand, and Disinfecting Wipes. "Innovation is not about planting seeds," Clorox's former CEO, Jerry Johnston, explained at a Product Development & Management Association conference. "It's about avoiding distractions."

But such discipline is hardly the norm. More typical is a leading packaged goods company, whose 600 active projects commanded resources up and down R&D, marketing, the supply chain, and sales. So many projects were under way, and management of them was so diffuse, that it was impractical to quantify the value they would deliver. This is when commoditization creeps in by the back door.

Colgate has long been a champion at producing a constant flow of innovative products that consumers are willing to pay more for: a toothbrush that cleans the tongue as well as the teeth, another that massages the gums, and one that bends and flexes for better performance. So, too, has Dyson, the English vacuum cleaner company. "As Dyson's share grew, we dragged the average price up...29%... and added \$200 million to the value of the market, [thus changing] how much [customers] were prepared to pay," Gordon Thom, the chairman of Dyson Japan, has been quoted as saying.

The company's machines arrived in the United States at a time when Hoover,

the established brand leader in the U.S., was innovating downward with simpler, cheaper products, reducing prices so that it could maintain its share of unit sales in the face of competition from low-price imports. As a result, Dyson captured the dollar share of the U.S. market for up-rights. Hoover was recently acquired from Whirlpool at a bargain price by a division of Hong Kong-based Techtronic Industries. Chris Gurreri, president of Techtronic's new Floor Care unit, was quoted as saying that the competition had "put a big noose around Hoover's neck."

Paul Calthrop (paul.calthrop@bain.com)

is a partner with Bain & Company in Melbourne, Australia.

Reprint F0705G

R&D

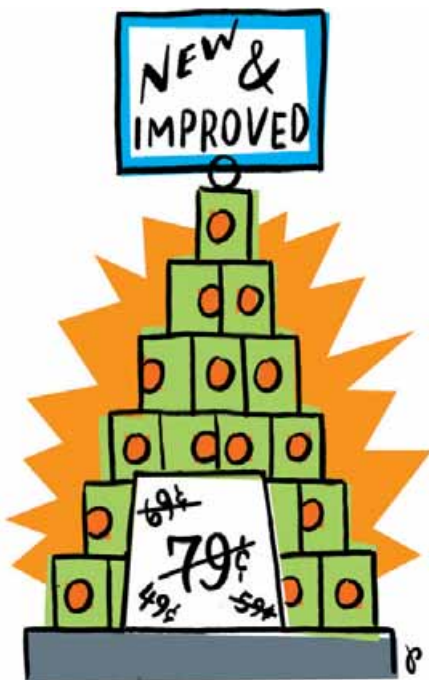
Getting Unusual Suspects to Solve R&D Puzzles

by Karim R. Lakhani and
Lars Bo Jeppesen

For even the toughest of R&D problems, there are often people out there with innovative solutions already on their shelves or in their back pockets. The trick for corporate executives is finding and gaining access to those individuals. Our research with a company that broadcasts technological problems into the ether—and gets back solid results—has given us a profile of the kind of people most likely to solve R&D puzzles. We wonder whether firms might be able to emulate this method to draw new insights from the talents and expertise of their own employees.

A little background: Open-source software communities have shown that broadcasting technical conundrums to a broad network of individuals can yield effective solutions. Open-source problem solving has now migrated beyond software to industries as diverse as custom integrated circuits, biotechnology, pharmaceuticals, content production, and music.

Our profile was drawn using data from InnoCentive, the well-known Andover,



Wherever in the world you compete,
Michigan can give you the upper hand.



3

IN A SERIES OF THOUSANDS

When it came to solar technology, Michigan was the brightest spot.



Impact. That's what United Solar Ovonic is all about. Well, technically, they're about solar power. But, the underlying theme is certainly impact. They're the world's largest manufacturer of thin-film solar panels. Their technology touches anywhere the sun touches. Their manufacturing facility holds a machine the length of a football field. And the work they do could change the way every one of us lives in our homes. Now that's impact.

Turns out, Michigan has also had an impact upon President & COO Dr. Subhendu Guha. After all, United Solar Ovonic's world headquarters and two manufacturing facilities are located in Auburn Hills. They even plan to expand to Greenville. Why here? Because Michigan fast-tracked a competitive advantage with prime locations, the best economic incentives and access to great research facilities. Thanks to the Michigan Economic Development Corporation, businesses that come here find success.

Your success is no exception. In Michigan, you have access to the \$2 billion 21st Century Jobs Fund. PLUS, Michigan is home to an experienced, tech-savvy workforce and world-renowned research universities. In fact, we're ranked #2 among all states for patents awarded to public universities. Technology clusters, economic incentives, capital funding sources... the list goes on.

So, to shed a little light on your success, head to the bright spot. Because wherever in the world you compete, Michigan can give you the upper hand. Let the Michigan Economic Development Corporation show you how. **Call 800 878 7722 or click on michigan.org.**



*Dr. Subhendu Guha, President & COO
United Solar Ovonic
A subsidiary of Energy Conversion Devices, Inc.*

MICHIGANSM
ECONOMIC DEVELOPMENT CORPORATION

THE UPPER HAND
michigan.org

Massachusetts, company that posts corporate R&D problems for outsiders to solve, offering substantial monetary prizes. In collaboration with InnoCentive, client companies have learned to break up their problems in sophisticated ways to avoid revealing strategy and other proprietary information. In a remarkable 30% of cases, problems that could not be solved by experienced corporate research staffs were cracked by nonemployees. When we analyzed all the problems broadcast from 2001 to 2004, we found that on average, each one received detailed attention from more than 200 people and received ten solution submissions. It's similar to what the British Parliament did in 1714 when it solicited ideas for obtaining longitude at sea and got a solution from an unknown Yorkshire clock maker, John Harrison.

We were curious about today's John Harrisons. What fields are they in? What motivates them? Could a system in which companies post their R&D problems for outsiders ultimately replace an internal R&D staff? Through our studies with Jill Panetta and Peter Lohse of InnoCentive, we found these answers:

Problems should be broadcast to people in varied fields. Radical innovations often happen at the intersections of disciplines. In fact, the more diverse the problem-solving population, the more likely a problem is to be solved. People tend to link problems that are distant from their fields with solutions they've encountered in their own work.

A pharmaceutical firm's researchers were stumped, for instance, by the unexpected results they encountered from a toxicology test in a drug study, even after consulting with toxicologists inside and outside the company. After being broadcast by InnoCentive, the puzzle was solved by a scientist with a PhD in protein crystallography who didn't normally encounter toxicology problems but was able to apply methods common in her field. In another case, an aerospace physicist, a small-agribusiness owner, a specialist in transdermal drug delivery, and an industrial scientist came up with entirely unique solutions to a problem in polymer science.



Prizes are necessary but not sufficient. Our analysis shows that prize money is important in motivating individuals to participate—people expect financial rewards for solving corporations' problems, and, indeed, firms must pay for solutions in order to retain the IP rights to them. But the enjoyment of taking on a novel problem is a bigger draw: We found no significant correlation between the size of the prize and a problem's likelihood of being solved.

Insiders are still important. Scientists and engineers inside the company are critically important in determining which problems should be broadcast and which potential solutions are best. And they are needed to help implement the solutions in products.

It's also possible, theoretically, to post problems internally. Some large corporations may be heterogeneous enough to include significant numbers of John Harrisons. Presumably, firms could use our research as a guideline, broadcasting problems to the most diverse possible population, offering prizes but emphasizing the fun of the problem-solving process, and reassuring R&D staffs that their

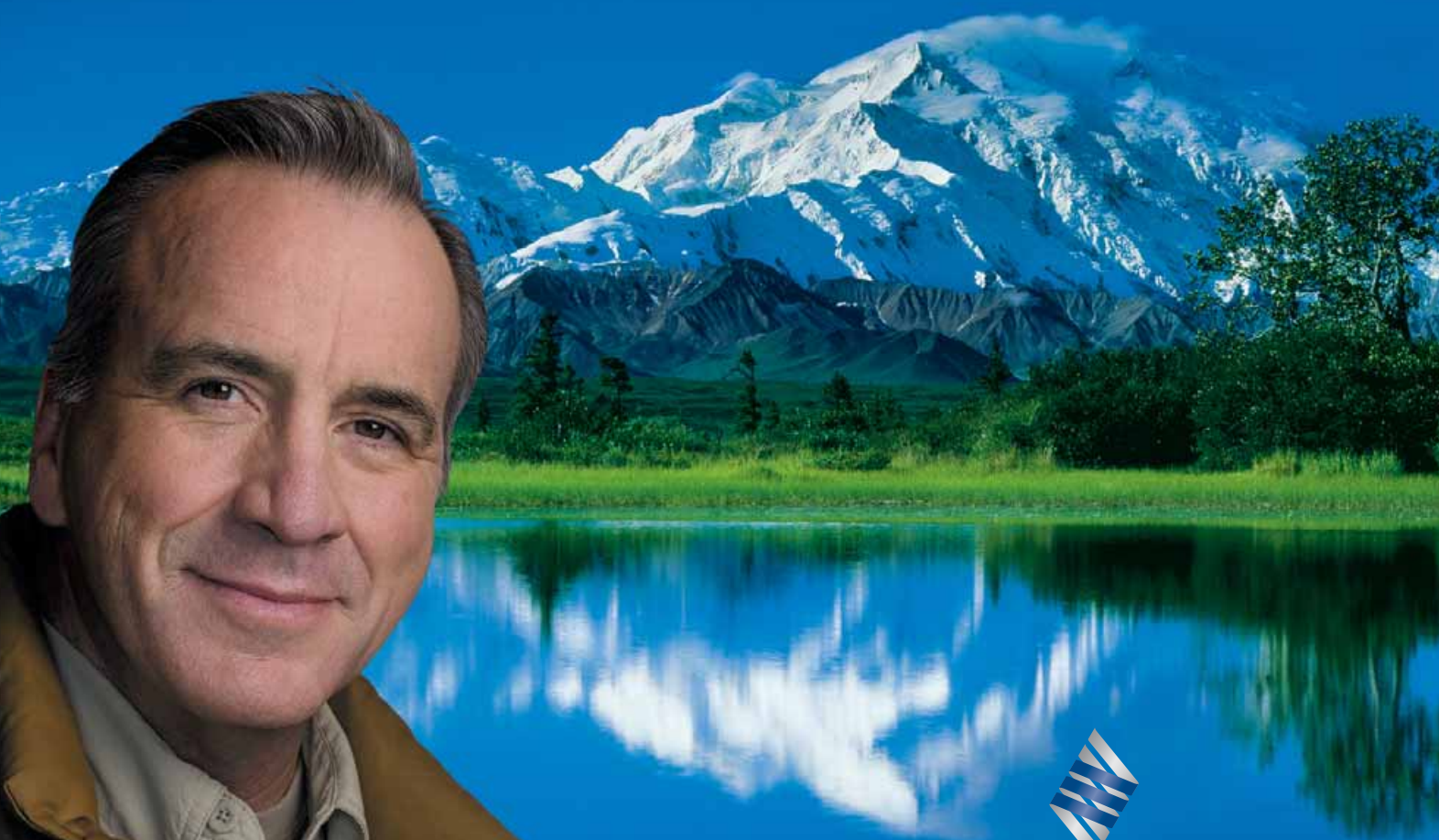
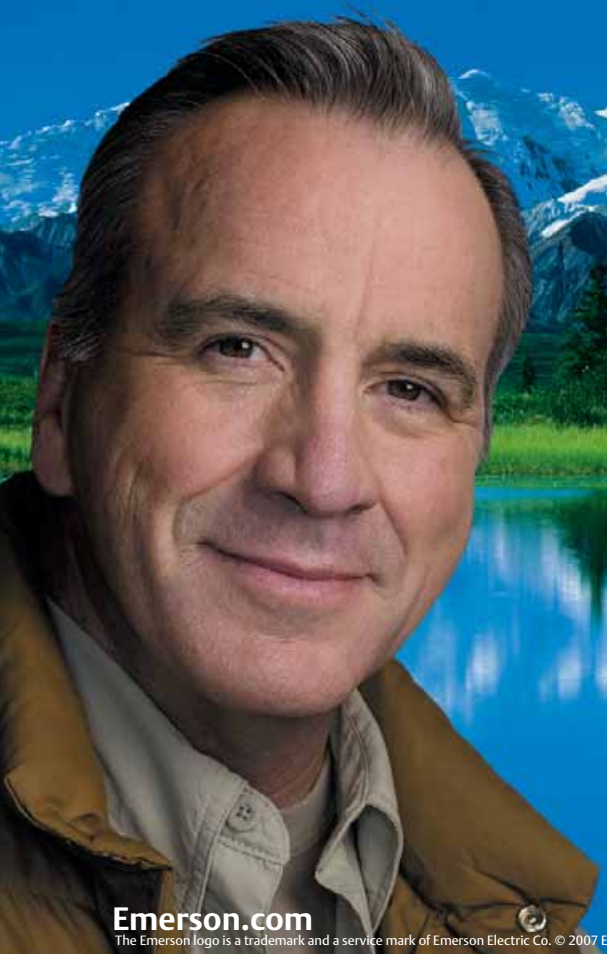
jobs are not in jeopardy. We are planning to run experiments in which we broadcast a problem both inside and outside a company and compare the results. We hope to find ways in which organizations can create successful innovations by reaching across traditional organizational silos.

Studies indicate that companies shouldn't waste resources vainly looking for the right people to solve some of their trickiest problems. It's more effective to encourage a diverse group of people outside the company, or the discipline, to seek innovative solutions. Individuals capable of finding solutions often do exist, and they're often willing to invest the necessary hours. The solvers in our study reported spending, on average, about two weeks creating their solutions. If people are excited by the challenge, they can find the time.

Karim R. Lakhani (klakhani@hbs.edu) is an assistant professor at Harvard Business School, in Boston. **Lars Bo Jeppesen** (lbj.ivs@cbs.dk), an assistant professor at Copenhagen Business School, in Denmark, is the director of its Danish User-Centered Innovation Lab. **Reprint F0705H**

Demand for energy will call for
a cleaner way to burn coal.

Are you ready?



Emerson.com

The Emerson logo is a trademark and a service mark of Emerson Electric Co. © 2007 Emerson Electric Co.



EMERSON™

CONSIDER IT SOLVED™

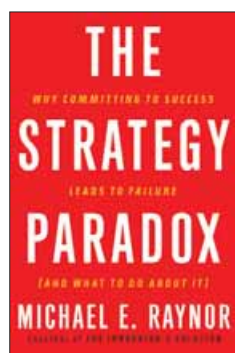
Network Power • Process Management • Climate Technologies • Storage Solutions • Industrial Automation • Motor Technologies • Appliance Solutions • Professional Tools

Reviews

The Strategy Paradox Why Committing to Success Leads to Failure (and What to Do About It)

by Michael E. Raynor
(Currency, 2007)

Michael Raynor has turned into a disruptive thinker in his own right. Better known until recently as Harvard Business School professor Clayton Christensen's coauthor—they teamed up to write *The Innovator's Solution* in 2003—Raynor explores a provocative thesis in his new book. Strategies that have the



greatest chance of success, he argues, also have the highest probability of failure. The paradox arises because companies base strategies on specific beliefs or ideas about the future. The future is uncertain, however, and strategies succeed mostly because of luck; companies make what somehow proves to be the right choices. If they are unlucky, the same commitments prove to be the wrong ones—and enterprises fail.

Anticipating the skeptics' response, Raynor defends his two key assumptions: first, that companies can't develop projections that will allow them to make consistently successful strategy commitments

and, second, that companies can't adapt if they guess wrong. "There is always something out there that one cannot adapt to," he says.

If you can't predict and you can't adapt, what do you do?

To answer that question, Raynor engages us in a fresh conversation about strategy. Since the paradox is a structural problem, he proposes a simple structural solution that links hierarchy, time horizons, and uncertainty. Senior executives, responsible for long-term decisions, should focus on managing uncertainty; midlevel managers must translate the possibilities created by senior executives into commitments that functional managers must fulfill. And managers lower down the hierarchy should concentrate on delivering the commitments companies have already made.

Finally, Raynor describes a four-part tool set that companies can use to create strategic flexibility: building scenarios (anticipating); developing strategy responses for each scenario (formulating); deciding what strategic options are needed (accumulating); and managing the portfolio of real options (operating).

Both scenario-planning and real options are well-known tools, with more than their fair share of detractors. Raynor argues that by integrating them and grounding them in the organizational hierarchy, companies can create a novel response mechanism. However, he leaves the reader with a nagging feeling of distrust with his choice. Don't novel paradoxes demand novel tools?

Raynor appears to spend more time describing the problem than suggesting innovative ways of tackling it. Perhaps this book presents the dilemma—and the solution is likely to follow. He does have a point, though, when he says that traditional strategic planning incorrectly treats uncertainty as an afterthought. In today's world, companies would do better to build their strategies on the bedrock of uncertainty—not after assuming it away.

—Anand P. Raman

Damage Control: Why Everything You Know About Crisis Management Is Wrong

Eric Dezenhall and John Weber
(Portfolio, 2007)

Ever since the Tylenol-tampering incident in 1982, crisis management has emphasized expressing regret, taking responsibility, redressing harms, and convincing the public of one's good intentions. Dezenhall and Weber, two consultants, instead see most crises as assaults in the marketplace from determined adversaries unlikely to be won over. From the Audi "sudden acceleration" scam in America in 1986 to the supposed tainted Coke episode in Europe in 1999, they conclude, executives are better off responding to the reported facts according to the context of deeper public perceptions and the company's likely opposition. While some cases do call for immediate capitulation, the authors intelligently tell executives to prepare for hardball in many others. As for Tylenol, rather than a model of feel-good effectiveness, they persuasively show, it was an atypical case involving as much luck as wisdom.

God at Work: The History and Promise of the Faith at Work Movement

David W. Miller
(Oxford University Press, 2007)

Just as religion and spirituality are surmounting practical objections and gaining legitimacy in corporate life, here comes a book to make the trend sustainable. Miller, a former investment banker and now divinity school professor, usefully charts the history of previous attempts to put religion into business. An earlier attempt after World War II fizzled, he says, largely owing to lack of support from clergy and seminaries. The new wave of interest, he explains, arose in reaction to the corporate layoffs and scandals of the 1980s, but he says individual seekers still lack institutional support. He urges religious institutions to get beyond tired antibusiness clichés and recognize the prowork thinking deep in their traditions. This academic book offers only brief examples of that thinking, and it says little about religions other than Christianity. But it's the most thoughtful attempt so far to take both religion and business seriously as partners.

—John T. Landry

PUTTING TOGETHER THE RIGHT TEAM ISN'T JUST ABOUT HEAD COUNT.



The Predictive Index®
is a practical, proprietary
behavioral assessment tool
that improves bottom line
performance by helping
you hire, develop and
retain talented people.

It's about aligning individual capacities and performance with specific business goals. The Predictive Index® (PI) — a proven, scientifically-validated behavioral assessment tool — helps you do just that. With a 50-year track record of success, PI offers a fresh understanding of the factors that contribute to on-the-job performance and productivity. So you can build teams that really get somewhere.



PI Worldwide
People Smart. Results Driven.®

FOR A FREE "PUTTING TOGETHER THE RIGHT TEAM" POSTER, PLEASE VISIT WWW.PIWORLDWIDE.COM



**... is knowing when
you need someone most,
they'll be there.**

At Perot Systems, we approach every business relationship with a firm commitment to earn and retain our client's trust. It is a critical component of every IT, consulting, applications, and business process solution we deliver. We are a worldwide team of skilled professionals who thrive on providing high-quality, quantifiable results you can count on.

"We outsourced most of our IT to Perot Systems back in 1998 and it is one of the best strategic decisions we ever made. They've earned our deepest trust in every way by contributing to the success of many key business initiatives."

*G. Gilmer Minor III,
Chairman,
Owens & Minor, Inc.*

For us, the true benchmark of success is being there when clients need us most and coming through when challenges are greatest. That's how we build lasting trust.

When you need a teammate to help your business soar to new heights, we'll be up to the challenge. Call us at 1 888 30 PEROT, or visit www.perotsystems.com.

CONSULTING / BUSINESS PROCESSES / APPLICATIONS / INFRASTRUCTURE

perotsystems®

© Copyright 2007 Perot Systems



The Dark Side of Customer Analytics

An insurance company finds some intriguing patterns in the loyalty card data it bought from a grocery chain – the correlation between condom sales and HIV-related claims, for instance. How can both companies leverage the data responsibly?

by Thomas H. Davenport and Jeanne G. Harris

LAURA BRICKMAN WAS GLAD she was almost done grocery shopping. The lines at the local ShopSense supermarket were especially long for a Tuesday evening. Her cart was nearly overflowing in preparation for several days away from her family, and she still had packing to do at home. Just a few more items to go: “A dozen eggs, a half gallon of orange juice, and—a box of Dip & Dunk cereal?” Her six-year-old daughter, Maryellen, had obviously used the step stool to get at the list on the counter and had scrawled her high-fructose demand at the bottom of the paper in bright-orange marker.

HBR's cases, which are fictional, present common managerial dilemmas and offer concrete solutions from experts.

Laura made a mental note to speak with Miss Maryellen about what sugary cereals do to kids' teeth (and to their parents' wallets). Taking care not to crack any of the eggs, she squeezed the remaining items into the cart. She wheeled past the ShopSense Summer Fun displays. "Do we need more sunscreen?" Laura wondered for a moment, before deciding to go without. She got to the checkout area and waited.

As regional manager for West Coast operations of IFA, one of the largest sellers of life and health insurance in the United States, Laura normally might not have paid much attention to ShopSense's checkout procedures – except maybe to monitor how accurately her purchases were being rung up. But now that her company's fate was intertwined with that of the Dallas-based national grocery chain, she had less motivation to peruse the magazine racks and more incentive to evaluate the scanning and tallying going on ahead of her.

Some 14 months earlier, IFA and ShopSense had joined forces in an intriguing venture. Laura for years had been interested in the idea of looking beyond the traditional sources of customer data that insurers typically used to set their premiums and develop their products. She'd read every article, book, and Web site she could find on customer analytics, seeking to learn more about how organizations in other industries were wringing every last drop of value from their products and processes. Casinos, credit card companies, even staid old insurance firms were joining airlines, hotels, and other service-oriented businesses in gathering and analyzing specific details about their customers. And, according to recent studies, more and more of those organizations were sharing their data with business partners.

Laura had read a profile of ShopSense in a business publication and learned

that it was one of only a handful of retailers to conduct its analytics in-house. As a result, the grocery chain possessed sophisticated data-analysis methods and a particularly deep trove of information about its customers. In the article, analytics chief Steve Worthington described how the organization employed a pattern-based approach to issuing coupons. The marketing department understood, for instance, that

"Exclusive rights to our data will give you information that your competitors won't be able to match. No one else has the historical data we have."

after three months of purchasing nothing but Way-Less bars and shakes, a shopper wasn't susceptible to discounts on a rival brand of diet aids. Instead, she'd probably respond to an offer of a free doughnut or pastry with the purchase of a coffee. The company had even been experimenting in a few markets with what it called GoodSense messages – bits of useful health information printed on the backs of receipts, based partly on customers' current and previous buying patterns. Nutritional analyses of some customers' most recent purchases were being printed on receipts in a few of the test markets as well.

Shortly after reading that article, Laura had invited Steve to her office in San Francisco. The two met several times, and, after some fevered discussions with her bosses in Ohio, Laura made the ShopSense executive an offer. The insurer wanted to buy a small sample of the grocer's customer loyalty card data to determine its quality and reliability; IFA wanted to find out if the ShopSense information would be meaningful when stacked up against its own claims information.

With top management's blessing, Steve and his team had agreed to provide IFA with ten years' worth of loyalty card data for customers in southern Michigan, where ShopSense had a high share of wallet – that is, the supermarkets weren't located within five miles of a "club" store or other major rival. Several months after receiving the tapes, analysts at IFA ended up finding some fairly strong correlations

between purchases of unhealthy products (high-sodium, high-cholesterol foods) and medical claims. In response, Laura and her actuarial and sales teams conceived an offering called Smart Choice, a low-premium insurance plan aimed at IFA customers who didn't indulge.

Laura was flying the next day to IFA's headquarters in Cincinnati to meet with members of the senior team. She would be seeking their approval to buy more of the ShopSense data; she wanted to continue mining the information and refining IFA's pricing and marketing efforts. Laura understood it might be a tough sell. After all, her industry wasn't exactly known for embracing radical change – even with proof in hand that change could work. The make-or-break issue, she thought, would be the reliability and richness of the data.

"Your CEO needs to hear only one thing," Steve had told her several days earlier, while they were comparing notes. "Exclusive rights to our data will give you information that your competitors won't be able to match. No one else has the historical data we have or as

Thomas H. Davenport (tdavenport@babson.edu) is the President's Distinguished Professor of Information Technology and Management at Babson College, in Wellesley, Massachusetts, and the director of research for Babson Executive Education. Jeanne G. Harris (jeanne.g.harris@accenture.com) is an executive research fellow and a director of research at the Accenture Institute for High-Performance Business. She is based in Chicago. Davenport and Harris are the coauthors of *Competing on Analytics* (Harvard Business School Press, 2007).



many customers nationwide.” He was right, of course. Laura also knew that if IFA decided not to buy the grocer’s data, some other insurer would.

“Paper or plastic?” a young boy was asking. Laura had finally made it to front of the line. “Oh, paper, please,” she replied. The cashier scanned the groceries and waited while Laura swiped her card and signed the touch screen. Once the register printer had stopped chattering, the cashier curled the long strip of paper into a thick wad and handed it to Laura. “Have a nice night,” she said mechanically.

Before wheeling her cart out of the store into the slightly cool evening, Laura briefly checked the total on the receipt and the information on the

back: coupons for sunblock and a reminder about the importance of UVA and UVB protection.

Tell It to Your Analyst

“No data set is perfect, but based on what we’ve seen already, the ShopSense info could be a pretty rich source of insight for us,” Archie Stetter told the handful of executives seated around a table in one of IFA’s recently renovated conference rooms. Laura nodded in agreement, silently cheering on the insurance company’s uberanalyst. Archie had been invaluable in guiding the pilot project. Laura had flown in two days ahead of the meeting and had sat down with the chatty statistics expert and some mem-

bers of his team, going over results and gauging their support for continuing the relationship with ShopSense.

“Trans fats and heart disease—no surprise there, I guess,” Archie said, using a laser pointer to direct the managers’ attention to a PowerPoint slide projected on the wall. “How about this, though: Households that purchase both bananas and cashews at least quarterly seem to show only a negligible risk of developing Parkinson’s and MS.” Archie had at first been skeptical about the quality of the grocery chain’s data, but ShopSense’s well of information was deeper than he’d imagined. Frankly, he’d been having a blast slicing and dicing. Enjoying his moment in the spotlight, Archie went on a bit longer than

he'd intended, talking about typical patterns in the purchase of certain over-the-counter medications, potential leading indicators for diabetes, and other statistical curiosities. Laura noted that as Archie's presentation wore on, CEO Jason Walter was jotting down notes. O.Z. Cooper, IFA's general counsel, began to clear his throat over the speakerphone.

Laura was about to rein in her stats guy when Rusty Ware, IFA's chief actuary, addressed the group. "You know, this deal isn't really as much of a stretch as you might think." He pointed out that the company had for years been buying from information brokers lists of customers who purchased specific drugs and products. And IFA was among

share that kind of information? As a benefit to society?"

Several managers at the table began talking over one another in an attempt to respond. "Correlations, no matter how interesting, aren't conclusive evidence of causality," someone said. "Even if a correlation doesn't hold up in the medical community, that doesn't mean it's not useful to us," someone else suggested.

Laura saw her opening; she wanted to get back to Jason's point about competitive advantage. "Look at Progressive Insurance," she began. It was able to steal a march on its rivals simply by recognizing that not all motorcycle owners are created equal. Some ride

At that point, Archie begged to show the group one more slide: sales of prophylactics versus HIV-related claims. The executives continued taking notes. Laura glanced again at the clock. No one seemed to care that they were going a little over.

Data Decorum

Rain was in the forecast that afternoon for Dallas, so Steve Worthington decided to drive rather than ride his bike the nine and a half miles from his home to ShopSense's corporate offices in the Hightower Complex. Of course, the gridlock made him a few minutes late for the early morning meeting with ShopSense's executive team. Lucky for him, others had been held up by the traffic as well.

The group gradually came together in a slightly cluttered room off the main hallway on the 18th floor. One corner of the space was being used to store prototypes of regional in-store displays featuring several members of the Houston Astros' pitching staff. "I don't know whether to grab a cup of coffee or a bat," Steve joked to the others, gesturing at the life-size cardboard cutouts and settling into his seat.

Steve was hoping to persuade CEO Donna Greer and other members of the senior team to approve the terms of the data sale to IFA. He was pretty confident he had majority support; he had already spoken individually with many of the top executives. In those one-on-one conversations, only Alan Atkins, the grocery chain's chief operations officer, had raised any significant issues, and Steve had dealt patiently with each of them. Or so he thought.

At the start of the meeting, Alan admitted he still had some concerns about selling data to IFA at all. Mainly, he was worried that all the hard work the organization had done building up its loyalty program, honing its analytical chops, and maintaining deep customer relationships could be undone in one fell swoop. "Customers find out, they stop using their cards, and we stop get-

"Customers find out, they stop using their cards, and we stop getting the information that drives this whole train."

the best in the industry at evaluating external sources of data (credit histories, demographic studies, analyses of socioeconomic status, and so on) to predict depression, back pain, and other expensive chronic conditions. Prospective IFA customers were required to disclose existing medical conditions and information about their personal habits – drinking, smoking, and other high-risk activities – the actuary reminded the group.

The CEO, meanwhile, felt that Rusty was overlooking an important point. "But if we're finding patterns where our rivals aren't even looking, if we're coming up with proprietary health indicators – well, that would be a huge hurdle for everyone else to get over," Jason noted.

Laura was keeping an eye on the clock; there were several themes she still wanted to hammer on. Before she could follow up on Jason's comments, though, Geneva Hendrickson, IFA's senior vice president for ethics and corporate responsibility, posed a blue-sky question to the group: "Take the fruit-and-nut stat Archie cited. Wouldn't we have to

hard (young bikers), and some hardly ride (older, middle-class, midlife crisis riders). "By putting these guys into different risk pools, Progressive has gotten the rates right," she said. "It wins all the business with the safe set by offering low premiums, and it doesn't lose its shirt on the more dangerous set."

Then O.Z. Cooper broke in over the speakerphone. Maybe the company should formally position Smart Choice and other products and marketing programs developed using the ShopSense data as opt in, he wondered. A lot of people signed up when Progressive gave discounts to customers who agreed to put devices in their cars that would monitor their driving habits. "Of course, those customers realized later they might pay a higher premium when the company found out they routinely exceeded the speed limit – but that's not a legal problem," O.Z. noted. None of the states that IFA did business in had laws prohibiting the sort of data exchange ShopSense and the insurer were proposing. It would be a different story, however, if the company wanted to do more business overseas.

ting the information that drives this whole train,” he said.

Steve reminded Alan that IFA had no interest in revealing its relationship with the grocer to customers. There was always the chance an employee would let something slip, but even if that happened, Steve doubted anyone would be shocked. “I haven’t heard of anybody canceling based on any of our other card-driven marketing programs,” he said.

“That’s because what we’re doing isn’t visible to our customers – or at least it wasn’t until your recent comments in the press,” Alan grumbled. There had been some tension within the group about Steve’s contribution to several widely disseminated articles about ShopSense’s embrace of customer analytics.

“Point taken,” Steve replied, although he knew that Alan was aware of how much positive attention those articles

“‘Directly’ being the operative word here,” Denise noted wryly, as she took her copy and passed the rest around.

Parsing the Information

It was 6:50 PM, and Jason Walters had canceled his session with his personal trainer – again – to stay late at the office. Sammy will understand, the CEO told himself as he sank deeper into the love seat in his office, a yellow legal pad on his lap and a pen and cup of espresso balanced on the arm of the couch. It was several days after the review of the ShopSense pilot, and Jason was still weighing the risks and benefits of taking this business relationship to the next stage.

He hated to admit how giddy he was – almost as gleeful as Archie Stetter had been – about the number of meaningful correlations the analysts had

...

Donna Greer gently swirled the wine in her glass and clinked the stemware against her husband’s. The two were attending a wine tasting hosted by a friend. The focus was on varieties from Chile and other Latin American countries, and Donna and Peter had yet to find a sample they didn’t like. But despite the lively patter of the event and the plentiful food, Donna couldn’t keep her mind off the IFA deal. “The big question is, Should we be charging more?” she mused to her husband. ShopSense was already selling its scanner data to syndicators, and, as her CFO had reminded her, the company currently made more money from selling information than from selling meat. Going forward, all ShopSense would have to do was send IFA some tapes each month and collect a million dollars annually of pure profit. Still, the deal wasn’t without risks: By selling the information to IFA, it might end up diluting or destroying valuable and hard-won customer relationships. Donna could see the headline now: “Big Brother in Aisle Four.” All the more reason to make it worth our while, she thought to herself.

Peter urged Donna to drop the issue for a bit, as he scribbled his comments about the wine they’d just sampled on a rating sheet. “But I’ll go on record as being against the whole thing,” he said. “Some poor soul puts potato chips in the cart instead of celery, and look what happens.”

“But what about the poor soul who buys the celery and still has to pay a fortune for medical coverage,” Donna argued, “because the premiums are set based on the people who can’t eat just one?”

“Isn’t that the whole point of insurance?” Peter teased. The CEO shot her husband a playfully peeved look – and reminded herself to send an e-mail to Steve when they got home.

What if IFA took the pilot to the next level and found out something that maybe it was better off not knowing?

had garnered for the company. Many of its card-driven marketing programs had since been deemed cutting-edge by others in and outside the industry.

Steve had hoped to move on to the financial benefits of the arrangement, but Denise Baldwin, ShopSense’s head of human resources, still seemed concerned about how IFA would use the data. Specifically, she wondered, would it identify individual consumers as employees of particular companies? She reminded the group that some big insurers had gotten into serious trouble because of their profiling practices.

IFA had been looking at this relationship only in the context of individual insurance customers, Steve explained, not of group plans. “Besides, it’s not like we’d be directly drawing the risk pools,” he said. Then Steve began distributing copies of the spreadsheets outlining the five-year returns ShopSense could realize from the deal.

turned up. “Imagine what that guy could do with an even larger data set,” O.Z. Cooper had commented to Jason after the meeting. Exclusive access to ShopSense’s data would give IFA a leg up on competitors, Jason knew. It could also provide the insurer with proprietary insights into the food-related drivers of disease. The deal was certainly legal. And even in the court of public opinion, people understood that insurers had to perform risk analyses. It wasn’t the same as when that online bookseller got into trouble for charging customers differently based on their shopping histories.

But Jason also saw dark clouds on the horizon: What if IFA took the pilot to the next level and found out something that maybe it was better off not knowing? As he watched the minute hand sweep on his wall clock, Jason wondered what risks he might be taking without even realizing it.

How can these companies leverage the customer data responsibly? Four commentators offer expert advice.



George L. Jones is the president and chief executive officer of Borders Group, a global retailer of books, music, and movies based in Ann Arbor, Michigan.

SURE, A CUSTOMER database has value, and a company can maximize that value in any number of ways – growing the database, mining it, monetizing it. Marketers can be tempted, despite pledges about privacy, to use collected information in ways that seem attractive but may ultimately damage relationships with customers.

The arrangement proposed in this case study seems shortsighted to me. Neither company seems to particularly care about its customers. Instead, the message coming from the senior teams at both IFA and ShopSense is that any marketing opportunity is valid – as long as they can get away with it legally and customers don't figure out what they're doing.

In my company, this pilot would never have gotten off the ground. The culture at Borders is such that the managers involved would have just assumed we wouldn't do something like that. Like most successful retail companies, our organization is customer focused; we're always trying to see a store or an offer or a transaction through the customer's eyes. It was the same way at both Saks and Target when I was with those companies.

At Borders, we've built up a significant database through our Borders Rewards program, which in the past year and a half has grown to 17 million members. The data we're getting are hugely important as a basis for serving customers more effectively (based on their

instance, we avoid bombarding people with e-mails about a product they may have absolutely no interest in.

I honestly don't think these companies have hit upon a responsible formula for mining and sharing customer data. If ShopSense retained control of its data to some degree – that is, if the grocer and IFA marketed the Smart Choice program jointly, and if any offers came from ShopSense (the partner the customer has built up trust with) rather than the insurance company (a stranger, so to speak) – the relationship could work. Instead of ceding complete control to IFA, ShopSense could be somewhat selective and send offers to all, some, or none of its loyalty card members, depending on how relevant the grocer believed the insurance offer would be to a particular set of customers.

A big hole in these data, though, is that people buy food for others besides themselves. I rarely eat at home, but I still buy tons of groceries – some healthy, some not so healthy – for my kids and their friends. If you looked at a breakdown of purchases for my household, you'd say "Wow, they're consuming a lot." But the truth is, I hardly ever eat a bite. That may be an extreme example, but it suggests that IFA's correlations may be flawed.

Both CEOs are subjecting their organizations to a possible public relations backlash, and not just from the ShopSense customers whose data have been dealt away to IFA. Every ShopSense customer who hears about the

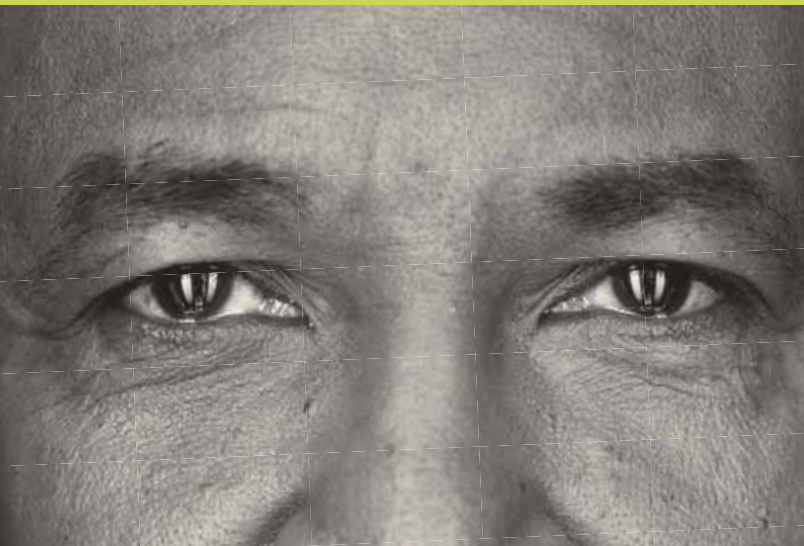
The message coming from both IFA and ShopSense is that any marketing opportunity is valid – as long as they can get away with it.

purchase patterns) and as a source of competitive advantage. For instance, we know that if somebody buys a travel guide to France, that person might also be interested in reading Peter Mayle's *A Year in Provence*. But we assure our customers up front that their information will be handled with the utmost respect. We carefully control the content and frequency of even our own communications with Rewards members. We don't want any offers we present to have negative connotations – for

deal, loyalty card member or not, is going to lose trust in the company. IFA's customers might also think twice about their relationship with the insurer. And what about the employees in each company who may be uncomfortable with what the companies are trying to pull off? The corporate cultures suffer.

What the companies are proposing here is very dangerous – especially in the world of retail, where loyalty is so hard to win. Customers' information needs to be protected.

RISK: WHAT'S YOUR UPSIDE?



There's a side of risk that's more valuable, and more rewarding. The upside. It's the insight to see risk others don't and unlock opportunities others can't. It's the know-how to optimize your insurability, and the market reach to reduce cost across your full spectrum of risk. Above all, it's confidence, allowing you to do things you simply couldn't do before. In every risk there's an upside, if you know how to look for it. And nobody can find it like the people of Marsh. To learn more, visit findtheupside.com

FIND THE UPSIDESM **MARSH**

 MARSH KROLL MERCER GUY CARPENTER



Katherine N. Lemon
(kay.lemon@bc.edu) is an associate professor of marketing at Boston College's Carroll School of Management. Her expertise is in the areas of customer equity, customer management, and customer-based marketing strategy.

AS THE CASE STUDY illustrates, companies will soon be able to create fairly exhaustive, highly accurate profiles of customers without having had any direct interaction with them. They'll be able to get to know you intimately without your knowledge.

From the consumer's perspective, this trend raises several big concerns. In this fictional account, for instance, a shopper's grocery purchases may directly influence the availability or price of her life or health insurance products—and not necessarily in a good way. Although the customer, at least tacitly, consented to the collection, use, and transfer of her purchase data, the real issue here is the *unintended* and *uncontemplated* use of the information (from the customer's point of view). Most customers would probably be quite surprised to learn that their personal information

rate increases. The insurer's general counsel should investigate this deal.

Another concern for consumers is what I call "battered customer syndrome." Market analytics allow companies to identify their best and worst customers and, consequently, to pay special attention to those deemed to be the most valuable. Looked at another way, analytics enable firms to understand how poorly they can treat individual or groups of customers before those people stop doing business with them. Unless you are in the top echelon of customers—those with the highest lifetime value, say—you may pay higher prices, get fewer special offers, or receive less service than other consumers. Despite the fact that alienating 75% to 90% of customers may not be the best idea in the long run, many retailers have adopted this "top tier" approach to managing customer

Customer analytics are effective precisely because firms do *not* violate customer trust.

could be used by companies in a wholly unrelated industry and in other ways that aren't readily foreseeable.

If consumers lose trust in firms that collect, analyze, and utilize their information, they will opt out of loyalty and other data-driven marketing programs, and we may see more regulations and limitations on data collection. Customer analytics are effective precisely because firms do *not* violate customer trust. People believe that retail and other organizations will use their data wisely to enhance their experiences, not to harm them. Angry customers will certainly speak with their wallets if that trust is violated.

Decisions that might be made on the basis of the shared data represent another hazard for consumers—and for organizations. Take the insurance company's use of the grocer's loyalty card data. This is limited information at best and inaccurate at worst. The ShopSense data reflect food bought but not necessarily consumed, and individuals buy food at many stores, not just one. IFA might end up drawing erroneous conclusions—and exacting unfair

relationships. And many customers seem to be willing to live with it—perhaps with the unrealistic hope that they may reach the upper echelon and reap the ensuing benefits.

Little research has been done on the negative consequences of using marketing approaches that discriminate against customer segments. Inevitably, however, customers will become savvier about analytics. They may become less tolerant and take their business (and information) elsewhere.

If access to and use of customer data are to remain viable, organizations must come up with ways to address customers' concerns about privacy. What, then, should IFA and ShopSense do? First and foremost, they need to let customers opt in to their data-sharing arrangement. This would address the "unintended use of data" problem; customers would understand exactly what was being done with their information. Even better, both firms would be engaging in trust-building—versus trust-eroding—activities with customers. The result: improvement in the bottom line and in the customer experience.

D&O LIABILITY: WHAT'S YOUR UPSIDE?



The fear of liability exposure in today's regulatory environment can stifle the ability of directors and officers to make the decisions needed to grow their business. Marsh brings to bear unmatched diagnostic and analytical capabilities to structure D&O insurance coverage tailored to your company's risk profile. The upside? Confidence to execute your strategic agenda. To learn more, visit findtheupside.com

FIND THE UPSIDESM MARSH

MMC MARSH MERCER
KROLL GUY CARPENTER



David Norton (dnorton@harrahs.com) is the senior vice president of relationship marketing at Harrah's Entertainment, based in Las Vegas.

TRANSparency is a critical component of any loyalty card program. The value proposition must be clear; customers must know what they'll get for allowing their purchase behavior to be monitored. So the question for the CEOs of ShopSense and IFA is, Would customers feel comfortable with the data-sharing arrangement if they knew about it?

ShopSense's loyalty card data are at the center of this venture, but the grocer's goal here is not to increase customer loyalty. The value of its relationship with IFA is solely financial. The company should explore whether there are some customer data it should exclude from the transfer—information that could be perceived as exceedingly sensitive, such as pharmacy and alcohol purchases. It should also consider doing market research and risk modeling to evaluate customers' potential reaction to the data sharing and the possible downstream effect of the deal.

The risk of consumer backlash is lower for IFA than for ShopSense, given the information the insurance company already purchases. IFA could even put a positive spin on the creation of new insurance products based on the ShopSense data. For instance, so-called healthy purchases might earn customers a discount on their standard insurance policies. The challenge for the insurer, however, is that there

sages (to some customers, an offer of tickets to a live performance might be more interesting than a dining discount, for example). But we think the internal transactional data are much more important.

We do rely on analytics and models to help us understand existing customers and to encourage them to stick with us. About ten years ago, we created our Total Rewards program. Guests at our hotels and casinos register for a loyalty card by sharing the information on their driver's license, such as their name, address, and date of birth. Each time they visit one of our 39 properties and use their card, they earn credits that can be used for food and merchandise. They also earn Tier Credits that give them higher status in the program and make them eligible for differentiated service.

With every visit, we get a read on our customers' preferences—the types of games they play, the hotels and amenities they favor, and so on. Those details are stored in a central database. The company sets rules for what can be done with the information. For instance, managers at any one of our properties can execute their own marketing lists and programs, but they can target only customers who have visited their properties. If they want to dip into the overall customer base, they have to go through the central relationship-marketing group. Some of the information captured in our online joint promotions is accessible to both Harrah's and its business partners, but the promotions are clearly positioned as opt in.

We tell customers the value proposition up front: Let us track your play at our properties, and we can help you enjoy the experience better with richer rewards and improved service. They understand exactly what we're capturing, the rewards they'll get, and what the company will do with the information. It's a win-win for the company and for the customer.

Companies engaging in customer analytics and related marketing initiatives need to keep "win-win" in mind when collecting and handling customer data. It's not just about what the information can do for you; it's about what you can do for the customer with the information.

Would customers feel comfortable with the data-sharing arrangement if they knew about it?

is no proven correlation between the purchase of certain foods and fewer health problems. IFA should continue experimenting with the data to determine their richness and predictive value.

Some companies have more leeway than others to sell or trade customer lists. At Harrah's, we have less than most because our customers may not want others to know about their gaming and leisure activities. We don't sell information, and we don't buy a lot of external data. Occasionally, we'll buy demographic data to fine-tune our marketing mes-

CRITICAL SUPPLY CHAIN: WHAT'S YOUR UPSIDE?



Supply chains are becoming increasingly global, complex, and vulnerable. Marsh can help you identify and assess risk at every stress point in your supply chain, implementing risk mitigation and insurance programs to reinforce and strengthen every link. The upside? A more reliable and resilient supply chain. To learn more, visit findtheupside.com

FIND THE UPSIDESM **MARSH**

AMC MARSH KROLL MERCER GUY CARPENTER



Michael B. McCallister
(mmccallister@humana.com)
is the president and CEO of Humana, a health benefits company based in Louisville, Kentucky.

COMPANIES THAT CAN CAPITALIZE on the information they get from their customers hold an advantage over rivals. But as the firms in the case study are realizing, there are also plenty of risks involved with using these data. Instead of pulling back the reins, organizations should be nudging customer analytics forward, keeping in mind one critical point: Any collection, analysis, and sharing of data must be conducted in a protected, permission-based environment.

Humana provides health benefit plans and related health services to more than 11 million members nationwide. We use proprietary data-mining and analytical capabilities to help guide consumers through the health maze. Like IFA, we ask our customers to share their personal and medical histories with us (the

patterns, as the insurance company in the case study does? It might be. I could see the upside of using a grocer's loyalty card data to develop a wellness-based incentive program for insurance customers. (We would try to find a way to build positives into it, however, so customers would look at the interchange and say "That's in my best interest; thank you.") But Humana certainly wouldn't enter into any kind of data-transfer arrangement without ensuring that our customers' personal information and the integrity of our relationship with them would be properly protected. In health care, especially, this has to be the chief concern – above and beyond any patterns that might be revealed and the sort of competitive edge they might provide. We use a range of industry standard security measures, including

When the tougher, gray-area decisions need to be made, each person has to have the company's core principles and values in mind.

risky behaviors as well as the good habits) so we can acquaint them with programs and preventive services geared to their health status.

Customer data come to us in many different ways. For instance, we offer complimentary health assessments in which plan members can take an interactive online survey designed to measure how well they're taking care of themselves. We then suggest ways they can reduce their health risks or treat their existing conditions more effectively. We closely monitor our claims information and use it to reach out to people. In our Personal Nurse program, for example, we'll have a registered nurse follow up with a member who has filed, say, a diabetes-related claim. Through phone conversations and e-mails, the RN can help the plan member institute changes to improve his or her quality of life. All our programs require members to opt in if the data are going to be used in any way that would single a person out. Regardless of your industry, you have to start with that.

One of the biggest problems in U.S. health care today is obesity. So would it be useful for our company to look at grocery-purchasing

encryption and firewalls, to protect our members' privacy and medical information.

Ethical behavior starts with the CEO, but it clearly can't be managed by just one person. It's important that everyone be reminded often about the principles and values that guide the organization. When business opportunities come along, they'll be screened according to those standards – and the decisions will land right side up every time. I can't tell people how to run their meetings or who should be at the table when the tougher, gray-area decisions need to be made, but whoever is there has to have those core principles and values in mind.

The CEOs in the case study need to take the "front page" test: If the headline on the front page of the newspaper were reporting abuse of customer data (yours included), how would you react? If you wouldn't want your personal data used in a certain way, chances are your customers wouldn't, either. 

Reprint R0705A

Reprint Case only R0705X

Reprint Commentary only R0705Z

To order, see page 147.

Image of W.B. Yeats, poet and Nobel Prize winner,
by Louis le Brocquy.



**The Irish mind.
Rich in the raw material that will help
to realize the potential of your business.**

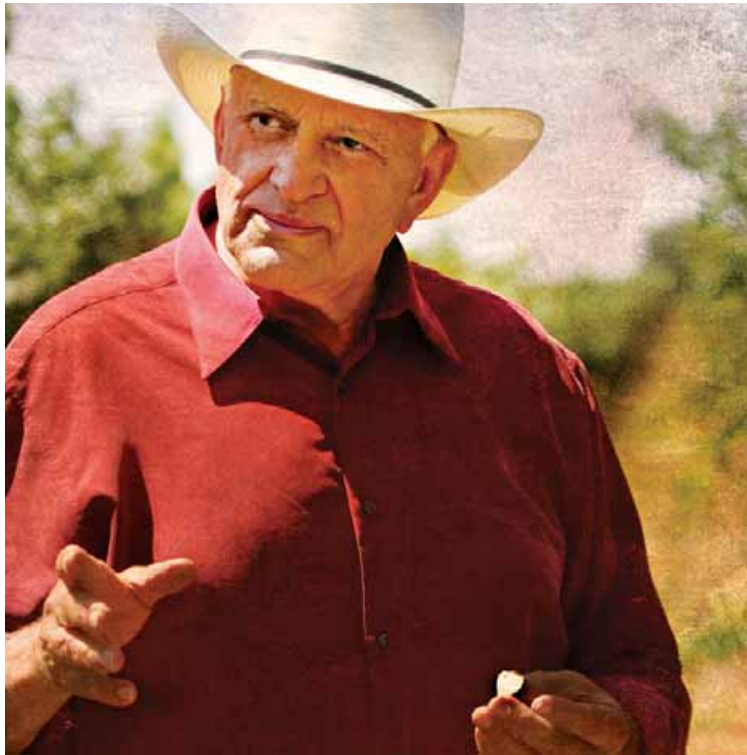
The Irish. Creative. Imaginative. And flexible. Agile minds with a unique capacity to initiate, and innovate, without being directed. Always thinking on their feet. Adapting and improving. Generating new knowledge and new ideas. Working together to find new ways of getting things done. Better and faster.

This flexible attitude pervades the ecosystem. Nowhere else will you find such close, frequently informal, links between enterprise, education and research facilities and a pro-business Government. Connected by a dynamic information infrastructure. In Ireland, everything works together.

With its innate knowledge and flexibility, the Irish mind can be the pathway to profit for your business.

To learn more, contact the Irish Government's inward investment agency, IDA Ireland, 345 Park Avenue, New York on 212 750 4300, e-mail idaireland@ida.ie or log on to www.idaireland.com





Jess Jackson, Taylor Peak Estate, Bennett Valley



Understanding the *grand cru* concept allows us to make our wine taste even better. Simply stated, *grand cru* is the French concept of designating a specific single vineyard, estate or château as showing the highest potential for greatness. Factors that determine this distinction are the superior balance of well-drained soils, preponderance of thin soil, the micro-weather of that special place such as angle of light to the sun, and the level of exposure to warm temperatures and cooling moisture from coastal fog or mist.

The *grand cru* concept is the approach my family and I have adopted when selecting the land that will produce our grapes.

We have found that the mountains, ridges, hillsides and benchlands along California's cool coastal region possess the ideal terroir to deliver world-class grapes with rich, intense and complex flavors. This is where you will find our Jackson Estates Grown Vineyards. We select the finest grapes from our best estate vineyards and blend them to make our highly celebrated Vintner's Reserve. In other words, the ultimate blending of *grand cru*. Because we believe you can taste the difference.

It is my understanding that many of you enjoy the taste of our wines but aren't sure why. Hopefully, I can help with the facts and **A Taste of the Truth.**



Back in Fashion

How We're Reviving a British Icon

After achieving record profits in 1998, Marks & Spencer lost sight of what had made it a beloved British retailer for a century – and as a result, profitability plummeted by 85%. By focusing on just three things, we are turning the business around.

by Stuart Rose

WHEN I TOOK OVER Marks & Spencer in the spring of 2004, I immediately realized that the previous management's idea of delegating decision making to the lowest possible level had gone horribly wrong. Major decisions were being made by people not experienced enough to make them. We had assistant buyers spending £30 million to £40 million of the company's money without oversight. Imagine that happening in ten different departments—which was the case at M&S. More than £300 million was being committed without senior management's sign-off. It was anarchy and very high risk. While delegating decisions is a good philosophy, it works only if those at the top of the organization are watching and supporting their teams.

The board and audit committee had known a year earlier that the company was carrying too much inventory, but nothing

had been done about it, and no one had been held accountable. One of my first decisions was to put someone in charge of stock management and tell him that there were two crimes he had to avoid: being overstocked and being short of stock. Now, every Monday at 12:30 PM, he reports back with an update on where inventory stands. We scrutinize our total stock – what's on order, what's in the warehouses, current supplier commitments, and so on. Problems are not allowed to fester. This is probably the most important thing I've done as CEO.

With a focus on fundamentals like stock control (which had been forgotten amid scores of consultant memos) and with the support of a strong executive team, I've tried to steer Marks & Spencer back to the levels of profitability it achieved before its sharp decline. Back in 1998, M&S was the first British retailer to reach a profit of £1 billion. Just a few years later, profits were down to £145 million. The problem was, M&S lost its customers' trust; it lost sight of what had made it great for more than 100 years.

Today we're back on track. In November 2006, we posted half-year profits of £405.1 million – up 32.2% from the previous fiscal year. The company's turnaround has been almost entirely due to its renewed focus on the basics of the business. I have never wanted to use the word “strategy” to describe what we've done, because that makes it sound terribly complicated, and it's not. As I told the board when I accepted the CEO position, three things needed doing right away: improve the product, improve the stores, and improve the service. It was – and still is – that simple.

Stuart Rose is the CEO of the London-based retailer Marks & Spencer. He is also a non-executive director of the UK property development company Land Securities and the chairman of the British Fashion Council. Previously, he served as the chief executive of Arcadia, Booker, and Argos, all of which are based in the UK.

First Battles First

I had wanted the job of running Marks & Spencer long before it was offered to me. I spent my formative career years here – in a variety of roles in the textiles and food divisions and then as the head of European operations. Although I left M&S in 1989, its allure always remained.

For those outside the UK, it is difficult to understand just how powerful the M&S brand is. It is a national institution. Two prime ministers, Margaret

**Three things needed
doing right away:
improve the product,
improve the stores,
and improve the service.
It was – and still is –
that simple.**

Thatcher and John Major, both famously said they bought their underwear at Marks & Spencer, just like nearly a third of the people in the UK. For decades schoolchildren have known that the requisite trip to M&S for new uniforms signals the end of summer. Professionally, I was brought up there. Although I led three other companies in the 15 years after I left M&S, it was a bit like the first girl you really loved. You could never quite get her out of your heart.

So as I witnessed M&S's painful decline – from 1998 to 2000 the company lost more than two-thirds of its market cap – I kept looking for my chance to come back. In May 2004, after months of speculation, it was announced that then-chairman Luc Vandewelde would be leaving, and I thought there might be an opportunity for me. As it turns out, my timing was good.

I met with nonexecutive director Kevin Lomax at 10:30 in the morning on Thursday, May 27, 2004. By 2:00 PM that same day, retail investor Philip Green, now Sir Philip, had signaled his intention to launch an £8 billion hostile takeover bid. By 6:00 PM, the company's bankers had asked if I could meet with the board the next morning. Over the weekend, the entire management landscape shifted. On Monday it was announced that I was the new CEO of Marks & Spencer and that my

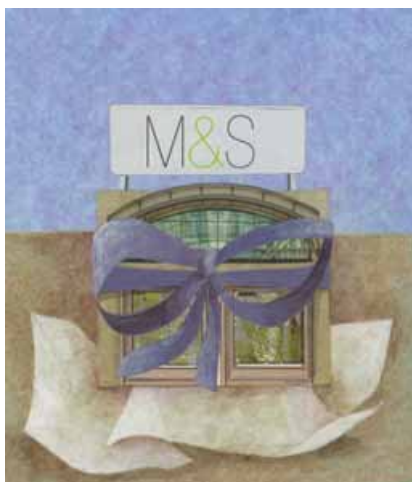


predecessor, Roger Holmes, together with Luc Vandewelde, had departed.

I knew I had a turnaround on my hands, but I didn't realize the scope until I actually saw M&S's books the weekend I agreed to become CEO. Most frustrating of all, I couldn't get started right away. The first six weeks of my tenure were spent fighting off Philip Green's bid, the largest hostile takeover attempt in the UK to date. Every morning at 8:00, as many as 30 people would gather in a room for what we called the prayer meeting. The battle for M&S would ultimately be waged in the press, so we spent our mornings planning how to make our case. Typically, I would spend three hours making press calls and doing radio and TV interviews. It was relentless.

The entire management team at M&S would prove to be crucial in the turnaround, but for the media battle, I had to be at the front. The press cov-

erage boiled down to the perceived strengths of the possible management teams – one led by Green, who owns two of the UK's largest retailers (British Home Stores and Arcadia Group), and the other by me. Though I'd been chief executive of three other companies, I probably earned my reputation as a turnaround specialist at Arcadia, where I inherited a company with £250 million of debt and trading losses in 2000 and engineered a £855 million sale to Green in 2002. The press reveled in the idea of



pitting Green and me against each other. During the life of Green's bid for Marks & Spencer, there were about 2,000 articles on M&S a month – and at least twice we were the lead item on the BBC 10:00 news, ahead of Iraq. It was surreal.

Clearly, the battle hinged on our ability to convince reporters, analysts, and investors that I was the one to lead M&S back to prosperity. Having such intense scrutiny of you personally, as a leader, can cause self-doubt. There were times when I wondered if I really could pull it off—especially because every moment I spent fighting the battle was a precious moment I wasn't working on getting M&S back on track. I tried to squeeze in meetings with heads of departments early in the morning to start planning, but it was hard to find the time I needed.

On July 12, I outlined my plan for Marks & Spencer, which, most importantly, included focusing on the core

values that had made M&S an icon, as well as selling off our financial services business to HSBC Bank and buying the Per Una womenswear brand from its creator, George Davies. In essence, I promised to turn M&S back into the kind of store that customers loved. Two days later, Green withdrew his bid.

I allowed myself to celebrate for about two minutes.

Although the entire company had begun a long-planned move to new corporate offices during the height of the



takeover battle, I had stayed with a small team in the historic Baker Street headquarters to remain focused. On that July morning, rattling around in the nearly empty building, I was acutely aware of being alone. All the advisers were gone – with their fees. Philip Green was off on his boat for a six-week holiday. I sat there thinking, “I need a holiday desperately,” and I hadn't even started yet.

Don't Even Consider a Plan B

It took about a week to decide whether we could actually pull off what I'd said we could do. I didn't give myself too much time to think about it because I didn't want to be seduced into changing my mind. People within M&S were already lobbying for different plans, different strategies. So I began a campaign to hammer home just three things: product, store environment, and ser-

vice. We had to fix all of them, and fast. There was no Plan B.

Because the Christmas season is key to the entire retail year and to how industry analysts gauge a company's health, the clock was ticking. It would be at least six months before the actions I wanted to take had any effect. Assuming we started right away, we might be just in time for Christmas. Or we might already be too late.

The biggest problem was that the company was sitting on about £3 billion in inventory, and we were taking in only £4 billion in the first half of the year. We had 35 weeks' worth of stock. (To put that into perspective, by March 2005—less than a year later—we had reduced our stock and commitments by £1.3 billion, which brought us to a much healthier level.) And this was not the kind of stock we wanted to have. For most of its history, M&S had sold only one brand, its own St. Michael line, which had embodied the “value for money” philosophy. But during the 1990s, it had created something like 16 subbrands, few of them attracting any real customer following. A short-lived but expensive advertising campaign made the point that Marks & Spencer's female customers perhaps needed roomier and more practical clothing. Customers certainly didn't appreciate that message – naturally, they wanted something more aspirational. Our styles had become dowdy and the product quality increasingly inferior. The inventory wasn't moving. We were stuck in a rut of buying as far as six months in advance. In the UK fashion industry, which was moving faster than ever before, M&S was missing all the latest trends. We were left with mountains of stock that no one wanted to buy. We had no choice but to sell it at a discounted rate and take a hit on our margins.

A confluence of events had led to the rapid fall of M&S after our 1998 peak. First, the British financial community started to apply pressure for M&S to do something with all the cash it was generating. So the company began to

spread itself thinner in an effort to “invest” in its future while pushing margins and prices in order to drive still higher profits. The business also became inward looking rather than customer facing. It lost its focus on the product and the customer and got bogged down in processes and initiatives. Diverted from its retailing heartland, Marks & Spencer embarked on other ventures – an ultrahip furniture store, for instance, and a clothing brand for trendy young teenagers – which alienated its core customers.

As M&S was reveling in superretailer status, the UK retail market became much more competitive, but the company either didn't notice or just didn't take the competition seriously. In the years right after M&S hit peak profitability, rivals like Next drew more and more customers away with offers of high-quality and stylish clothing at great value. Supermarkets like ASDA (owned by Wal-Mart) began encroaching on traditional clothing retailer

the shops and hope they'd sell. It was a supply-led strategy, not a demand-led one.

As it became clear that one successful line could not, in reality, fuel a sustainable revival by itself, M&S suddenly discovered the allure of consultants. But for a company that had long prided itself on home-growing talent, the heralding of consultants to bring in “fresh” ideas sent a damaging message throughout the ranks. Looking to the outside for help was seen as an admission that M&S didn't have the talent within. Existing staff understood the message to be that they had contributed to the downfall of the business – and that management wanted to change the gene pool.

When I rejoined the business, there were 31 “strategic projects” being run by these consultants. There was constant change. The company was lurching from one strategy to another. If a strategy didn't work by Friday, a new one was initiated on Monday. The staff

I did was designed for clarity. I'd brought just two people with me when I took the job: Charles Wilson, the executive director of IT, supply chain, and property, and Steve Sharp, who later became the executive director of marketing and store design. I had worked closely with both of them during the years I was away from M&S, and I knew we had complementary strengths.

Knowing one another as well as we did, we were able to hit the ground running. The three of us went to work on the obvious, to deliver the things I'd promised. Wilson would need to find £260 million in immediate cost savings. Sharp would revamp our tired marketing and our company brand. I'd take care of the front of the house: the products, their pricing, and delivery to our stores.

First we looked at our supply base. We told the suppliers this wasn't just a Marks & Spencer problem; it was “our” problem. We were going to sink or swim together. We said, “If you can think about shaving your margins, we can turn a vicious cycle of high stocks, low stock turnover, low profitability, and low cash flow into more volume, better cash flow, and improved profitability. It'll be a virtuous circle – a win-win situation for M&S and for you.” I personally met with the top 30 suppliers in both foods and textiles, the majority of whom were long-term partners of M&S. In the end they all came to the party; we were able to trim £100 million off our supply chain costs – and we didn't lose a single supplier in the process.

That was only the beginning of what would be a major overhaul of our supply chain. We'd been doing things like purchasing fabric in one hemisphere and then shipping it to the other for manufacturing. It just didn't make sense. We eventually opened up five sourcing offices (strategically located in Hong Kong, India, Bangladesh, Turkey, and Sri Lanka) to help us make better decisions about the entire chain of purchasing and distributing our products.

For a company that had long prided itself on home-growing talent, the heralding of consultants to bring in “fresh” ideas sent a damaging message throughout the ranks.

space. Rather than using its market strength to see off these entrants, M&S got greedy. Prices kept going up, and value suffered. A few things helped camouflage the deep-rooted problems. For example, in 2001, when we launched the Per Una line, it brought half a million more customers to our stores each week. At the time, the success of that one line was widely viewed as the engine for a turnaround, and the media briefly toasted our “comeback.”

In hindsight, I think this uptick had a lot to do with buoyancy in the retail market in general. At its heart, the management team didn't really know why things were getting better and which things were working. No real core changes had been made. We used to just make products and put them in

became demoralized by the onslaught of ever-shifting, unclear messages and strategies, which led to more bad decisions about product and further damaged the way M&S dealt with customers. It was a rapid downward spiral.

Clean House

One of the most important messages I wanted to send to our staff was that they should trust their own judgment again. I led by example, relying on my gut and dispensing with all but ten of the ongoing strategic projects. I didn't do any research – in part because time was too precious. But also, it was a deliberate response to the consultant years, which were awash in numbers and surveys and complexity. Everything

Then we made changes closer to home. The most symbolic thing we did was to have a massive housecleaning. Because there were so many different subbrands in our shops, we had lots of signage and titles and names on cardboard cluttering up our stores. We had a skip delivered to all of the stores – every single one – and asked them to toss everything out. On the scale of things, that may not seem like a big deal, but it quickly made quite an impact on the way the stores looked and how employees felt. Retail analysts had long noted that the stores were too dark, too cluttered, and too bland, and they were right. The stores looked dated. We weren't in the same league as trendier retailers like Zara, Next, and Topshop. It was the beginning of a major store-by-store refurbishment program, which cost us more than £500 million by the end of 2006, with an additional £800 million earmarked after that.

More difficult was the housekeeping we had to do at corporate headquarters. At the time of Green's takeover bid, there were about 3,500 corporate employees. We determined that we had to cut 650 people across the board to achieve the cost savings we needed.

novation,' and 'trust.' Is quality still worth what it was in 1965? Is value? Is service? Is innovation? Is trust?" I knew what I wanted to do. I knew we had excellent people at Marks & Spencer – the homegrown talent had much to offer. But our people were disheartened

I used to say, "Look, in textiles you can do anything provided it's legal. In foods you can do anything provided it's legal and you don't kill anybody. Those are the only rules."

Having cut so many staff from a business as culturally embedded as ours, I had to spend probably 90% of my time over the next six months convincing people who were already pretty disillusioned that we were making progress. I spent a lot of time in meetings reiterating my key message: "What are the five words we've always used in our business? 'Quality,' 'value,' 'service,' 'in-

to the point of questioning everything. I wanted to push them to stop worrying about all the reasons something might not work or needed precedent. I used to say to them, "Look, in textiles you can do anything provided it's legal. In foods you can do anything provided it's legal and you don't kill anybody. Those are the only rules. Get on with it."

Selection can be this obvious.

Find, Hire and Retain Top Talent.

These strategic challenges require an accurate, efficient and cost-effective solution.

From entry-level to professional and executive, Select International offers assessments, Virtual Job Auditions™ and recruitment process outsourcing for companies who want to maximize their talent ROI. Call 1.800.786.8595 or log on to www.selectinternational.com.

PRODUCTS • SYSTEMS • OUTSOURCING

SELECT INTERNATIONAL



I had to get them to remember our core strengths and to start showing initiative. But at the same time, I knew they had, at least temporarily, lost their perspective on the fundamentals of what made our products great. I tried to sit in on all the meetings on product—on blouses, skirts, pants, men's ties, men's shirts, everything—so I would know very quickly whether they were going right or wrong. People myopically focused on the wrong things. For example, they'd triumphantly point out that a particular fabric had been made in a superfantastic factory. I'd say, "Yes, well, can you tell that to the customer?" And they'd say, "No...but the stitches are slightly more dense. See?" And I'd say, "Does it make any difference to wearability? What margin are you taking on this? What volume are you taking?" Our quality had to stand out, and it had to stand out at the right price. We were holding excruciatingly basic conversations, but I wanted to remind staff over

and over to go back to the core of what they knew. To think the way they used to. We had those conversations item by item, department by department.

I was trying to shake up a culture of paralysis. Hiding behind data or precedents to avoid making a decision had to stop. If it looks like a duck and it quacks like a duck, you don't need to send it for DNA testing to find out six months later it's a duck. Take a risk, guys. It's a duck.

Every now and then, there would be a glimmer of hope. One Sunday night, looking through *Vogue* magazine to bring myself up to date, I noticed some green espadrille shoes. I went to the footwear department the next morning and said, "Why haven't we got any shoes like this?" The following afternoon, the head of operations for footwear e-mailed me to say we'd designed our own espadrille, bought the raw materials, and briefed the factory in China, and we would have 12 dozen in our flagship store in ten days.

He got a bottle of champagne—and I used his story to illustrate just what could be achieved. I still talk about him. Fortunately, many employees have followed his example.

Invest in Staff

Little by little, as better-quality product began coming into the stores and customers started buying a bit more and grumbling a bit less, I could see the store teams begin to hold their heads up. That was a huge accomplishment in itself, because for five years customers had been wagging fingers at them—and some of them, in turn, had been giving worse service.

A lot of the reasons for poor service were not the fault of store staff. First, we had fallen behind in pay rates. We were in the lowest quartile of UK retailers on pay, and we were no longer attracting the quality of staff we wanted. During the crucial busy Christmas season of

NOW WHAT?

Advanced Executive Program

june 24–july 20

Executive Development Program

july 8–27

october 14–november 2

Programs where the business world's most courageous minds tackle its most challenging issues. execed.kellogg.northwestern.edu

847-491-3100



Kellogg
School of Management



2004, more than 2,000 people failed to show up for temporary positions—they had received more lucrative offers elsewhere. Our turnover rate for new staff was nearly 80% within the first two years of service. We couldn't sustain that. There were hundreds of different hourly rates for customer assistants. We narrowed the range and brought the scale into the top quartile of UK retail industry compensation. Perhaps most important, we instituted a clear reward structure. Traditionally, we had rewarded only length of service. If you had been at M&S for 15 years and you gave bad service, you still got a raise. We started insisting that store managers rate the quality of service each employee provided – and offered raises only on that basis. For the first two years after we altered the pay structure, some of our longest-serving employees were not eligible for raises.

We also had to standardize working hours. For years our employees had been allowed to choose the hours they worked for us. Obviously, though, customers come in when they want to, not when we want them to. It was crazy. Getting adequate coverage meant changing our employee contracts. We had about 300 different types. We narrowed that down to just three.

Our career structure was also overly complex, and it didn't offer much hope for advancement. We streamlined that, too, down to just four levels for our store staff: the trainee and qualified positions, which already existed, and the newly created coach and section co-ordinator positions, which were designed both to offer people the prospect of career development and to enrich their training time before they moved to management.

Then we pulled out all the stops – certainly for a British institution like M&S – and gave our store staff a bit of what I'll call Billy Graham-type training. We brought in customer service consultant Mary Gober, the only consultant we've retained in my years as CEO. Over a nine-month period, starting in July 2005, the entire store work-

force, 56,000 people, attended motivational training sessions, sometimes 5,000 employees at a time. These covered the basics: making eye contact, working as a team, knowing what customers expect, that sort of thing. But it was like a religious revival – Gober got everyone to stand up and move their hands about. I think the employees were shocked at first, but by the end, people gave it high marks. At the same time, we began much more formal training for the 8,000 people in our new coach role. Gradually, we started to see feedback from customers that they believed our service was improving. Even better, the training and the clear career paths enabled employees to regain some of the pride they'd lost.

Lead with Your Strongest Assets

The most visible sign of progress was the refurbishment program, which we'd begun on a trial basis in stores around the country. It was clearly working. In the spring of 2005, we realized we should be trying to roll that out even faster, but it was pretty complicated. We were ordering things on a massive scale: 100 escalators, 100 lifts, 20 miles of refrigerators. I should have insisted we move faster (indeed, by the autumn of 2006 analysts were pressing us to do so), but it seemed too much to ask at the time. I didn't really hit the accelerate button until midsummer 2005 – and that cost us a valuable six months. In the stores we'd remodeled, we were beginning to see a return on our investment of around 17%. We were also totally changing customers' experience in our stores. We needed an environment in which people felt good about the premium they were being asked to pay for the quality of products we sold. Our food halls, for example, were now decked out with matte steel refrigerators and shiny black-tile floors.

We'd also finally regained our stride in advertising and marketing. We led from the food side of the business, because it had suffered less than the clothing side and for that reason was seen as

Corporate Governance: Effectiveness and Accountability in the Boardroom

september 4–7

Market Access Strategies: Leveraging Your Channels of Distribution

september 9–12

Strategic Marketing Communications

september 9–12

Accelerating Sales Force Performance

september 16–20

Pricing Strategies and Tactics

september 16–19

Negotiation Strategies for Managers

september 16–19

Kellogg Management Institute

september 20–may 9, 2008

Governing the Family Business

october 7–11

Upcoming programs where the business world's most courageous minds tackle its most challenging issues.

execed.kellogg.northwestern.edu

847-491-3100



our stronger asset. We took a calculated gamble on heavily increasing our food advertising in the months immediately after I took over. The first new ad we did was simple: We showed the beautiful food we offered. Internally, we called it food pornography, because it zoomed in on every morsel, with a sensual voice-over from a well-known actress. It was a hit. Sales of the chocolate pudding shown in the ad increased by 3,000% right before Easter in 2005. It was a needed morale boost – and a signal to investors that we were on our way back up.

As for our much maligned women's clothing, once the crown jewel of M&S, we found the right spokesmodel for the message our typical customers *did* want to hear. We lured the 1960s fashion icon Twiggy – now a fabulous 50-something, like many of our customers – out of modeling retirement to be one of the new faces of M&S, alongside models Erin O'Connor, Laura Bailey, and Noémie Lenoir. Our customers responded enthusiastically. As we had done with food, we invested in high-profile advertising campaigns. Our best seller in womenswear, for example, is a £35 jersey dress modeled by Elizabeth Jagger (Mick Jagger's daughter).

We've aimed to create three price options in every type of product: good, better, best. Each represents good value. Our clothing isn't cutting-edge trendy, but it's fashionable. We're getting good reviews in the fashion pages, and our clothing market share is growing once again.

Keep It in Perspective

Three years into my tenure, with signs of health throughout the business, I recognize that it's time for me to take a step back from the level of micromanagement and focus on building for the future. We've extended the executive committee, which sits just under the main board. Previously, this committee consisted of me, Steve Sharp, and Ian Dyson (who replaced my initial CFO, Alison Reed, in 2005). It now includes

four other people who have played an important role in our success since 2004: Kate Bostock, the director of womenswear; Guy Farrant, the director of food; Anthony Thompson, the director of retail; and Andrew Skinner, previously the director of menswear and now the director of general merchandise planning, sourcing, and supply chain. When this expanded top management team started meeting this January, I realized that I would need to create a formal agenda for meetings, something I had never done before.

But I recognize, too, that developing people is key to an organized succession plan. In January I finally used the "r" word – "recovery" – in part to stop the relentless media scrutiny on whether we had or hadn't "recovered." We are now at a better place, and we're making good profits. There's more work to be done, though, just to carry out what I said I'd do three years ago, let alone take the business to the next stage. If you look at our growth over the past decade compared with, say, Tesco's, ours is U-shaped, and Tesco has had a straight line of continual growth year on year. Last year Tesco generated £750 million in profits on "development opportunities" alone. That was our total profit number. We still have a long way to go.

I've got to start thinking about where to take the business over the next four or five years if we do get all this done in the UK. Otherwise, we'll be back to where we started and stuck with the business we've got, which is the largest of the small retailers and the smallest of the large retailers in the UK. That's just not good enough.

Odd as it seems, the company is in a delicate position at the moment. Yes, we've gained back our confidence, and the media and investors seem to be championing our achievements. We've gone from zero to hero more quickly than we fell in the first place. But one must never let confidence become arrogance – and the most important person it must not happen to is me. I need somebody to occasionally whisper in my ear, "Remember, chief executive,

you're mortal." Fortunately, there is no shortage of volunteers doing just that.

And so I'm beginning to look forward. I hate the word "legacy," but I am trying to set some ambitious long-term goals to put M&S on a sustainable course. In January we announced a £200 million "eco-plan" – we're calling it Plan A – that will shape everything about the way we do business. M&S will become carbon neutral, have none of its waste going to landfills, ensure that as many of its raw materials as possible come from sustainable sources, raise the bar in ethical trading, and help customers and employees lead healthier lives – all by 2012. None of this will happen at the expense of value for money, on which we have built our reputation, and none at extra cost to customers.

We've created a 100-point plan outlining a wide range of significant commitments to fundamentally change the way we do business. Those include making ourselves 25% more energy efficient, powering our stores with "green" energy (generated, for instance, by waste from our food halls, farms, and factories), using 50% biodiesel fuel in all our trucks, recycling all the waste from our store remodeling program, and reducing the water used in our stores, offices, and distribution centers by 20%. We're also introducing a huge number of organic and healthy lifestyle products, and we expect to be a leader in managing labor standards in our supply chain. I'm proud of the ambitious scope of what we'll be trying to achieve in the next five years – and hopefully we'll do even more.

But I have to constantly remind myself that I am merely a guardian of this great business and that my job is to leave it in better condition than I found it. If I fell under a train tomorrow, I'd like the next CEO to be able to say, yes, I can work with what he built. He could have turned left but, thank God, he turned right. ▢

Reprint R0705B

To order, see page 147.

THE STANFORD DIFFERENCE.

At Stanford, we consider asset classes, investment strategies, sectors and regions of the world most investors either rarely hear about or don't have easy access to. It's how we work to keep our clients' portfolios a step ahead of the world's ever-changing investment climate. Stanford – a world apart in managing private wealth.



HARD WORK. CLEAR VISION. VALUE *for the CLIENT.*SM

stanfordfinancialgroup.com/hbr

Securities products and services offered through Stanford Group Company, member NASD/SIPC.

WE'RE



Xerox Global Services helps organizations Result? Service levels up. Processing costs

Where are mission-critical documents when you need them? In a file cabinet? A computer? Our professional and document outsourcing services digitize and manage critical

business processes, taking paper and manual steps out. The results are a dramatic reduction in processing costs, a significant improvement in workflow, and a distinct

xerox.com/retrieve 1-800-ASK-XEROX

TRIEVE



find, modify and manage documents instantly.
down. **There's a new way to look at it.**

competitive edge that comes from working faster and more efficiently than your competition. Who do we retrieve for? JPMorgan Chase & Co. and Enterprise Rent-A-Car

Company. We can do the same for you. To see how we handle everything from accounting and contracts to HR and legal, visit us today at xerox.com/retrieve.

XEROX®

Technology

Document Management

Consulting Services

**EVERYBODY KNOWS TURNOVER AT THE
TOP MEANS UPHEAVAL. BUT NEW
RESEARCH SHOWS JUST HOW BAD YOUR
CHANCES OF KEEPING YOUR JOB ARE.**

SURVIVING YOUR NEW CEO

by Kevin P. Coyne and Edward J. Coyne, Sr.

THE HIGHTURNOVER OF CEOS in the United States affects huge numbers of other executives. At the current rate, almost 50% of the largest American firms will have a new CEO within the next four years. Another 25,000 newly acquired companies will also report to new leaders. If you're a senior team member in a firm with a new chief executive, your career now depends on the views of a person you may not know. What's more, your history of successes and failures may not count for much. "Remember that you are starting over," says the internally appointed CEO of a top-ten U.S. insurance company. "No matter what your track record was—hey, it's different now."



Anecdotal stories of what happens to executive teams during CEO transitions are hardly comforting. Firings, organizational reshuffles, and canceled strategies result in abrupt and unwelcome career changes for a host of senior managers. If you're faced with a new CEO, three questions probably loom very large in your mind: How worried should I be? What will happen to me if I do get pushed out? If I stay on, what should I do to maximize the chances of prospering with my new boss?

To answer these questions, we built databases compiling rates of CEO and other high-level executive turnover from 2002 to 2004 at the top 1,000 U.S. companies, as determined by their market cap at the end of 2001 (see the sidebar "About the Research"). We also investigated the most recently reported employment status of executives who had left companies with new CEOs during that time. In addition, we interviewed more than a dozen CEOs who had taken over at least one very large company. Because of the nature of our research, the results we compiled are not absolute. By studying several constellations of data, however, we were able to make inferences about the effects of CEO turnover on executives.

One conclusion, in particular, is striking: Chances are high that executives will find themselves out the door. They're more likely than not to land in a lower position at a new company, to work in a much smaller firm, or to retire altogether. Despite this grim picture, our interviews with CEOs revealed steps you can take to survive and even thrive, depending on how you behave in the first few days, weeks, and months of the new leader's tenure. Taken to heart, this practical advice may help you stay on board.

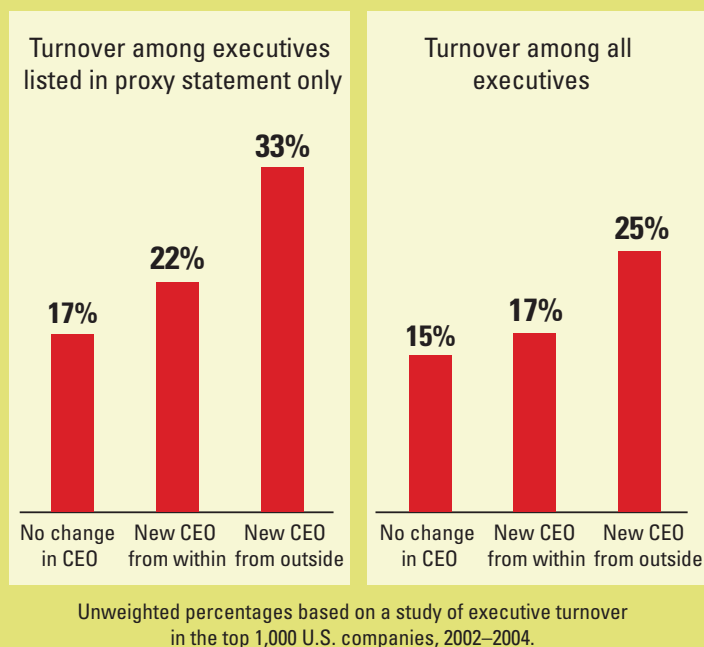
The Fate of Executives

To see what happens when a new chief executive takes over, we examined the turnover rates of proxy-level managers and other senior leaders in firms that maintained the status quo, promoted someone to CEO from within the company, or hired a new CEO from outside the company. We'll start with proxy-level executives.

Kevin P. Coyne (kcoyne@hbs.edu) teaches strategy at Harvard Business School in Boston and serves as a senior external adviser to McKinsey & Company. Edward J. Coyne, Sr., (ejcoyne@samford.edu) is an assistant professor at Samford University's School of Business in Birmingham, Alabama.

When a New CEO Enters, Executives Exit

Annual turnover among senior managers jumps dramatically when a new CEO takes the helm—particularly if he or she comes from outside the firm.



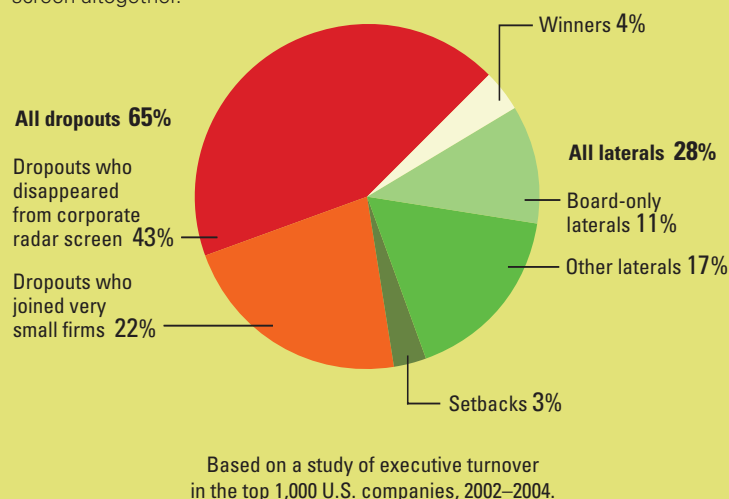
First, we looked at companies where the CEO remained constant. Proxy-level senior management turnover under those circumstances had a weighted average of 16% annually. Roughly half (about 8.5%) was voluntary, consisting of people who retired or who faced health or family issues, and that rate appeared to be unaffected by the company's performance. More important is the rate of involuntary turnover, including firings and unplanned early retirements. This averaged about 7.5% overall, with slight differences depending on how well the company was performing.

Next, we looked at the turnover rates for companies in which an internal executive had moved up the corporate ladder to the top spot. In such cases, the news was generally bad: The rate of involuntary turnover jumped up to 12.5%—an increase of about 65%. When we included voluntary turnover as well, the chances of a senior executive's leaving grew to more than one in five.

Then we considered cases in which the new CEO came from outside the company, which generally happens only in midperforming and low-performing firms (high-performing companies almost never replace their CEOs with outsiders). Here, the story gets much worse: Involuntary turnover averaged a whopping 26%—almost four times the rate when the

The Prospering Few

Senior managers who leave their jobs following a CEO replacement can be sorted into four categories: *Winners* accept a better position at a similarly sized company or keep the same title but move to a larger company. *Laterals* accept a lesser title at a larger company, maintain their former level at a similarly sized company, or take a better position at a smaller company. *Setbacks* accept a lesser position at a similarly sized or smaller company or keep their former title at a smaller company. *Dropouts* either join an extremely small venture or disappear from the corporate radar screen altogether.



CEO did not change. A further breakdown revealed that the involuntary turnover rate at companies with average performance was 24%, while the rate at poorly performing companies was 31%. Thus, overall, if you are listed in the proxy statement and your company brings in an outside CEO after a year of subpar performance, you have about a two in five chance of leaving your job.

What about other senior executives? The pattern for them was very similar to that for proxy-level executives but slightly less worrisome. On average, turnover among all executive officers rose only a little when the new CEO came from within the company but quite a lot when the CEO came from outside. In the latter situation, more than 25% left within a year, and the odds of an involuntary departure more than doubled (see the exhibit “When a New CEO Enters, Executives Exit”).

What happens to executives who leave? Is losing their job, as the cliché goes, “the best thing that ever happened to them”? Do they in fact land on their feet, or do they suffer massive career setbacks?

An executive who has been doing a good job may assume that even if he is asked to leave, he will find an equal or better job elsewhere and so may tend to be relaxed about his

fate under the new leader. Unfortunately, the data do not support this optimistic outlook. Of the approximately 400 proxy-level executives who left following the arrival of a new CEO in 2002 or 2003, none moved to a proxy-level job in any large U.S. firm. (To be fair, very few proxy-level executives who departed a company where the CEO remained constant found comparable jobs elsewhere either—but that’s cold comfort.)

The broader group of exiting executives generally fared poorly, too. We discovered this by comparing their previous companies and job titles with their new ones. We separated the executives into four categories—*winners*, *laterals*, *setbacks*, and *dropouts*—based on the combination of changes in their titles and the size of their employers. For example, a person who acquired a higher title at a slightly smaller firm might be classified as a lateral, but someone who accepted a lesser title at a much smaller firm would be classified as a setback.

Once again, the results are sobering. Winners were rare—only 4% of executives fell into this category. Twenty-eight percent fell into the laterals category (we gave former executives now serving exclusively as board members—almost a third of the laterals—the benefit of the doubt). Three

percent were designated setbacks. Fully 65%—the dropouts—moved to sole proprietorships or companies with sales of less than \$10 million (22%), or disappeared from our source databases altogether (43%). It seems likely that this last group either retired or moved quite far down the corporate ladder (see the exhibit “The Prospering Few”).

Younger executives may be tempted to believe that they stand a better chance of surviving than those closer to retirement age. Unfortunately, this is not the case. The overall pattern of success and failure for executives under the age of 52 is strikingly similar to the one for their older colleagues.

Given these outcomes, it’s clear that you would do well to try to keep your job under the new CEO—after all, you have nothing to lose. Your survival, however, may depend on whether you take the steps described below.

How to Survive

Every new CEO makes people decisions quickly: On average, the ones we interviewed said they had made final determinations about their teams within 60 days, even when they had publicly vowed to take their time. The statement of one well-known CEO at a \$10 billion services company, for example, is

You would do well to try to keep your job under the new CEO – after all, **you have nothing to lose.**

typical. When asked at his initial press conference whether there would be changes at the top, he replied that each member is valuable until proven otherwise and that making such a decision always takes a long time. Also typical is what occurred about a month later: He fired the CFO, who had put in a less-than-stellar appearance at an analysts' meeting.

Early impressions count – more than you know or maybe believe they should. New CEOs don't tend to seek input from their predecessors, and they place little weight on the input they do receive. Rather, they rely on their instincts. Since it's relatively rare for a board of directors to restrict a CEO's ability to change the management team, the impression you create with your new boss is critical.

Assuming that no force majeure exists to make your exit inevitable – for example, you're the CFO and the new leader brings along her own financial officer – how can you make a good first impression and maximize your chances of survival and success? We asked our CEO interviewees to look back on the earliest days of their new jobs and recall instances in which an executive's actions or behavior determined his or her fate. Did the executive do something to turn a negative impression into a positive one? Alternatively, did an otherwise good executive do – or fail to do – something that brought about his or her own downfall? We summarize their recommendations below.

Show your goodwill. It may be tempting to wait and see what the new CEO wants of you instead of taking the initiative to talk about your responsibilities, but this is the wrong approach. Most of the CEOs we interviewed indicated that too many executives doomed themselves from the start simply by failing to manifest a willingness to be part of the new team. As the chief executive of a \$20 billion industrial company put it, "Managers do not realize how much the CEO is looking for teammates on day one. I am amazed at how few people come through the door and say, 'I want to help. I may not be perfect, but I buy into your vision.' That alone makes a huge difference." Another CEO was even more frank: "Virtually no one came to see me to ask how they could help. It is naive and stupid for managers to hold back and be guarded."

It is also dangerous to assume that your new CEO already understands that you want to cooperate. According to our interviewees, the exiting executives who opposed the new CEO's program never once announced their opposition – so the leaders certainly did not equate silence with agreement. In the absence of strong signals, CEOs draw their own conclu-

sions about your views. If those conclusions are negative, their responses can be harsh. "It was clear to me," the head of a \$25 billion firm told us, "that the top executives of one of my largest divisions wanted no part of the new way of doing things at the company. They thought they could simply wait this out." He replaced every one of them within a year.

The consensus of our chief executives was clear. If you decide you want to stay, let the CEO know, proactively and without being sycophantic, that you want to be on the team, and follow up with actions that demonstrate your willingness to go along with the program. This is particularly important when the new leader has won an internal "horse race" and you were previously associated with a different candidate. In such a case, it is imperative to explicitly acknowledge that you accept the board's decision and show a constructive attitude. As the winner of an internal competition at a bank with \$100 billion in assets put it, "It would only be normal for a new CEO to be a little suspicious of people from other camps. So you must make a gesture – at least congratulate him – and follow up with action. You would be surprised how few people even do that."

Leave your baggage at the door. One CEO of a \$3 billion industrial conglomerate offered a list of specific don'ts: "Don't talk about [your compensation], even if you think you were grossly mistreated by the CEO's predecessor. That is not what he wants to deal with yet. Don't talk about your own long-term plans at the company, because your new boss hasn't decided whether you still have a career there yet. Don't raise issues about long-term difficulties you are having with other executives. He does not want to be cornered into choosing one side or the other until he decides what is needed." There will be time for all these things later, he added. "Right now, the CEO will not appreciate your thrusting your own agenda ahead of his, in any form."

Interestingly, our CEOs were adamant that executives should counsel their spouses – of either gender – to be scrupulously politic as well. Anything negative your spouse says is considered to be an unguardedly accurate reflection of your true views; and given the closeness of executive social circles, gossip about your dissatisfaction with the company can easily filter back to the CEO or the board. This, our interviewees agreed, is the kiss of death.

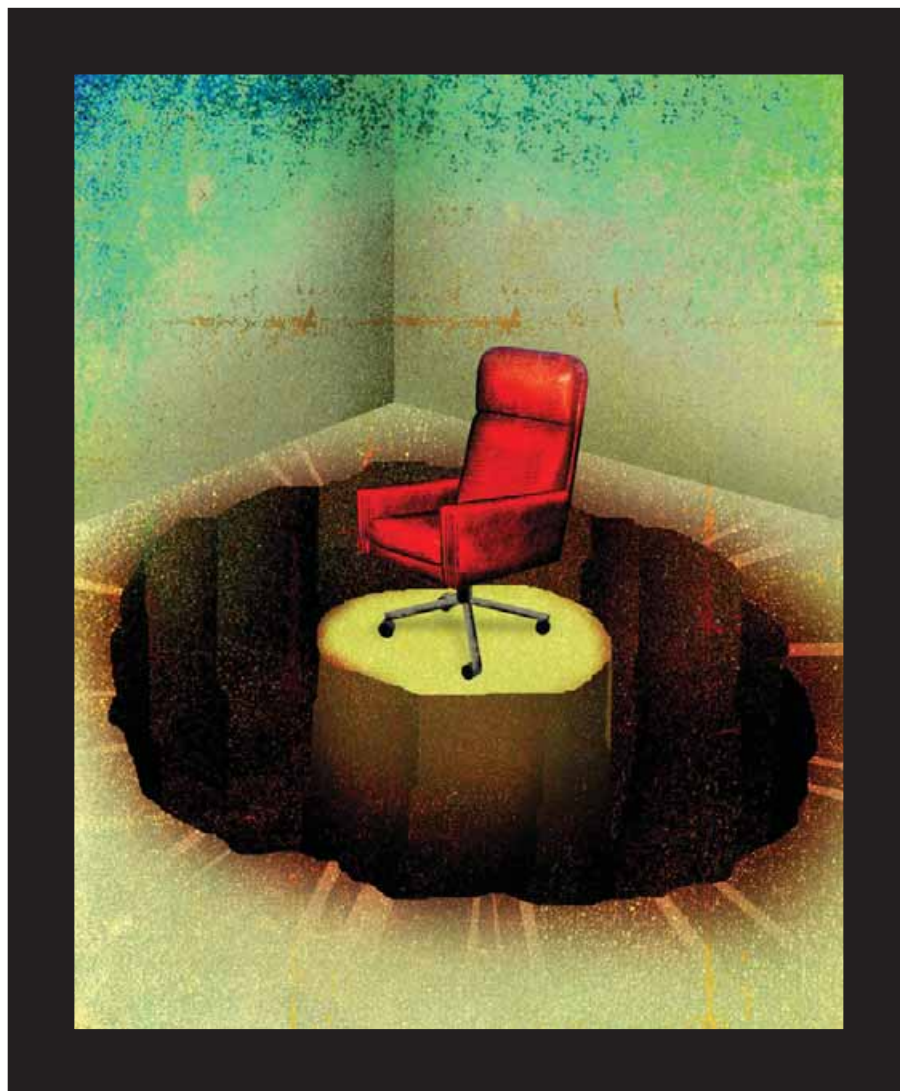
Study the CEO's working style. Our interviewees also told us that they wanted their direct reports to be sensitive to their working style and then match it. Because it can be difficult to discern your new boss's proclivities simply by

observation, it pays to ask about them specifically. One CEO recalled a meeting with a plain-spoken executive who company gossips predicted would be an early casualty of the new regime. “He told me he had a reputation for being blunt and then asked how I wanted him to disagree with me,” the CEO told us. “I wasn’t sure what he meant at first, but he went on to explain: What kind of facts cause me to change my mind—stories from the front line or statistics? Could he disagree in public or only in private? Once he had made his case and failed to convince me, should he try again or just accept that the decision was made? How did I feel about his subordinates or peers knowing he disagreed with something?” By asking intelligent questions about his new boss’s working style, the executive prospered throughout the CEO’s 12-year tenure.

Moreover, new leaders look for anything that points to potential ethical or behavioral conflicts. If you demonstrate a deaf ear or override the CEO’s signals, you can find yourself on the outs. One chief executive fired his head of sales on the basis of such discomfort. “I felt he was just a little sleazy,” he told us. “Nothing I could put my finger on, but he somehow made me uncomfortable. I didn’t exactly fire him just because of that, but it reduced my tolerance for any other problems. So when another issue came up, I acted right away.”

What about contacting your counterpart in the CEO’s former company or division in an effort to learn more about his tastes? On this point, our interviewees were split. Some felt that questions about communication style were perfectly fair, and the counterpart might even go further than expected and volunteer extremely valuable information that you didn’t ask for. Other CEOs felt that this gambit would be too risky because you don’t know anything about the personal relationship between the counterpart and the chief executive—or whether they still talk to each other. One particularly suspicious CEO put it this way: “How do you know that this guy isn’t already lobbying for your job?”

Understand the CEO’s agenda. According to our chief executives, senior managers could be substantially more



effective if they simply took a little time to put themselves in the newcomer’s shoes and made an effort to appreciate his or her agenda.

First, consider the pressure your new leader is under, especially when it comes to making a strong start. A study of 20 CEOs in 2003 by McKinsey & Company showed that a new chief executive’s fate depends heavily on the company’s stock performance during his or her first year of tenure. The researchers found that 75% of CEOs whose companies’ stock rose during the first 12 months were still in their jobs two years later, but 83% of those whose firms’ stock fell were gone by that time. Accordingly, your new boss will be looking for constructive suggestions about actions that he or she can take very quickly. Can you help?

The CEOs we spoke with also pointed out that executives need to confirm their understanding of the new agenda directly with their new boss. While our interviewees understood that their immediate actions sometimes confused their

direct reports, they also felt that had the executives made an effort to speak with them about their agendas, the confusion might have been avoided. Even if you've talked to board members about their possible directives for the new CEO, his plans for the company will be influenced by his background, judgments, and expertise, not just the board's disposition. It's important to hear about those ideas directly from him.

Present a realistic and honest game plan. It's only reasonable for a new CEO to expect you to be prepared to discuss the situation in your division and your plans for progress. Make sure you've thought everything through and then present the facts as clearly as possible. Don't make the mistake of sugarcoating them, however—that would be exactly the wrong approach. A too-rosy report will make your boss ask herself, "Who are you trying to kid?" One CEO who didn't receive straight information from a number of direct reports put it quite bluntly: "I don't have time to sort out trust issues. If you don't show me the negatives, I suspect that either you don't know them or that you will try to hide things from me. If you aren't open with me about problems, I assume you are covering up."

Be on your "A" game. Because your new CEO is on trial, too, it's important to help him or her show positive operating results—and soon. You can't afford to allow your organization to slip into paralysis because of the confusion attending a change at the top. This is no time to rest on your laurels. It's critical to demonstrate that you are active and competent and that important projects are moving full-steam ahead.

One new leader described winnowing the wheat from the chaff this way: "We had lots of interactions, including a four-hour executive meeting once a week. I simply observed who made sure to be there, who was prepared, who was action oriented, who identified solutions versus problems, and who actually followed through on what they said they would do." Based on these impressions, the CEO jettisoned almost half his direct reports within a year and another quarter of the original group in the subsequent six months.

A surprising proportion of our CEOs reported cases of executives who, perhaps assuming that they were invaluable, displayed a dismaying lack of political acumen during the critical "honeymoon" weeks. One leader told of a subordinate who took a two-week vacation during the CEO's first month on the job. "The vacation had been scheduled a long time, and I didn't stop him, but I still never forgave him," the CEO said. "It was the dumbest thing he could do." Several of our interviewees ranted about troop absences. "Can you believe he was out playing golf with customers half the time in my first six weeks?" one top executive at a \$15 billion consumer products firm raged. "He was never there when I tried to reach him. I developed serious questions about his priorities." Certainly, customer entertainment is a norm in many industries, but face time is critical when the new boss is forming impressions.

Another reason to be on top of your game during this period is that your CEO may be too busy to coach you. Per-

About the Research

In early 2006, using the most recent data available, we assembled a database comprising executives who were included in the 2002, 2003, and 2004 proxy statements of the top 1,000 companies (as determined by market cap) in the United States. There were, on average, four executives per organization, excluding the CEO. By comparing the companies' statements from year to year, we were able to learn what effects a change of top leadership in either 2002 or 2003 had on those executives.

We also created a database of changes among all those listed generally as "executive officers" (about ten per company) in the annual reports of a large sample of those firms during the same time period. This allowed us to look at the impact of CEO changes on a larger group of executives.

Next, we used Hoover's to determine the most recently reported employment status of the executives in our sample who had left their companies after a new CEO arrived. This gave us a wealth of statistical information about the aftermath of a shift in top leadership.

To confirm that the results in our sample years were indicative of longer trends, we cross-checked them with earlier academic work on management turnover. Our findings were remarkably consistent in both direction and degree.

We felt that practical advice would enrich our interpretation of the data, so we extensively interviewed more than a dozen professional CEOs who had taken over at least one very large, usually public, company. They represented a broad cross-section of industries, from high tech to financial services to consumer goods, and a wide range of sizes—from several hundred million dollars in sales to more than \$25 billion.

haps it's unfair, but the reality is that your new boss may not bother to tell you when you make a mistake; make two such errors and you are likely to be shown the door. If you do receive a warning, it may be discernible only from the questions you're asked about operational improvements or results. One new CEO, unsatisfied with the answers he was getting, began asking his head of operations more sharply worded questions over time. The responses did not improve, and the CEO dismissed him six weeks later. When asked if he ever sat the executive down and said, "This is not acceptable work," he laughed and replied, "You know, I guess I didn't. It never occurred to me. I was too busy."

The best way to improve your standing quickly is to take on a project—preferably a special one—in which you must interact extensively with the new leader over a short period of time. All our CEOs agreed on this point. When a third-tier

executive in a transportation company did an outstanding job of working with the CEO to reform the firm's customer service interface, for example, the chief executive promoted her to the senior management team. Your new boss will appreciate spending time with you, and if his initial impressions of you have been less than stellar, you might be able to turn his feelings around. No one will ever know whether any early casualties could have been avoided with the right exposure.

Offer objective options. Every new CEO has made difficult trade-offs to protect earnings or to invest in spite of earnings impacts; he has made choices between alternative growth paths and budgeting options. Every interviewee liked the idea of an executive objectively explaining previous budgeting decisions for his department, the rationale behind them, and how the new CEO's priorities might warrant a reassessment of some of those choices. An executive who demonstrates the willingness and ability to constructively engage in a discussion of budgetary options, and helps the CEO translate a new vision into tangible decisions, will be very welcome. Tellingly, not one of the CEOs we spoke with had ever worked with one.

Should you also immediately discuss major strategy changes with your new boss? The answer is, "It depends." One CEO thought it would be helpful to hear an unbiased assessment of the division's prospects and receive a thoughtful range of options that he or she might consider. Others

appreciated the sentiment, but felt that a new CEO would not yet be ready to assess strategic issues. Regardless of how or when you choose to discuss the alternatives, it is important not to appear self-serving; if you try to persuade the CEO to quickly invest huge amounts in your business, don't expect a warm reception. "I want real choices," one CEO said, "not end runs around the collective judgment of the other executives."

...

CEO changes are stressful for all senior executives. The danger of being pushed out is real, and the difficulty of landing on your feet is severe. On the other hand, opportunities are real, too. Many executives have reinvigorated their careers within a company after a change at the top; others have found fulfillment away from the corporate world.

Of course, whether or not you follow the advice of our interviewees is entirely up to you. The former CEO of one of the largest financial institutions in the country perhaps put it best when he said, "Make your personal decision about whether the new guy's style, vision, and business practices are ones you want to live with. Then commit or get out. Otherwise, everyone's life will be hell. And the result will be the same anyway." 

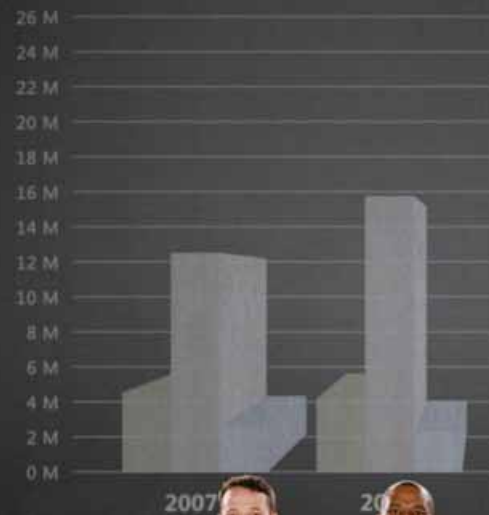
Reprint R0705C

To order, see page 147.



"If your résumé seems promising, you'll get to talk to him."

GROWTH OPPORTUN



A business collects data. A **people** **ready**



A people-ready business runs on Microsoft software.

How can your people turn mountains of data into major insights? Give them the right tools. Like Microsoft® Business Intelligence: solutions that give your people real-time views of your business, so they can make better decisions, faster. And to help keep everyone on the same page, Microsoft Business Intelligence solutions are incredibly intuitive. Why wouldn't they be? They're from Microsoft. Software for the people-ready business.SM microsoft.com/peopleready

Your potential. Our passion.™

Microsoft®

TIES



business knows what to do with it.

The first comprehensive look at what employees are thinking and feeling as they go about their work, why it matters, and how managers can use this information to improve job performance

by **Teresa M. Amabile and Steven J. Kramer**

Inner Work Life

**Understanding the Subtext
of Business Performance**

IF YOUR ORGANIZATION DEMANDS knowledge work from its people, then you undoubtedly appreciate the importance of sheer brain-power. You probably recruit high-intellect people and ensure they have access to good information. You probably also respect the power of incentives and use formal compensation systems to channel that intellectual energy down one path or another. But you might be overlooking another crucial driver of a knowledge worker's performance – that person's inner work life. People experience a

Leigh Wells



constant stream of emotions, perceptions, and motivations as they react to and make sense of the events of the workday. As people arrive at their workplaces they don't check their hearts and minds at the door. Unfortunately, because inner work life is seldom openly expressed in modern organizations, it's all too easy for managers to pretend that private thoughts and feelings don't matter.

As psychologists, we became fascinated a decade ago with day-to-day work life. But our research into inner work life goes well beyond intellectual curiosity about the complex operations of emotions, perceptions, and motivations. It addresses the very pragmatic managerial question of how these dynamics affect work performance. To examine this question, we constructed a research project that would give us a window into the inner work lives of a broad population of knowledge workers. Specifically, we recruited 238 professionals from 26 project teams and had them complete daily diary

watched you sitting quietly for a while, looking off into space, jotting down a few notes.

But would these observers really understand your inner work life that day? Of course not. In having those conversations and writing those reports, you were not only dealing with the task at hand. As events unfolded, you were also forming and adjusting perceptions about the people you work with, the organization you are part of, the work you do, and even yourself. You were experiencing emotions, maybe mild states of satisfaction or irritation, maybe intense feelings of pride or frustration. And these perceptions and emotions were intertwining to affect your work motivation from moment to moment – with consequences for your performance that day.

This is what we mean by inner work life: the dynamic interplay among personal *perceptions*, ranging from immediate impressions to more fully developed theories about what is

Would hidden observers watching you go through the day really understand your inner work life? Of course not.

entries, in a standard format, for the duration of their projects. Nearly 12,000 diary entries later, we have discovered the dynamics of inner work life and the significant effect it can have on the performance of your people – and, by implication, your entire organization.

It may stun you, if you are a manager, to learn what power you hold. Your behavior as a manager dramatically shapes your employees' inner work lives. But the key levers in your hands for driving motivation and performance may not be the ones you'd suspect.

More Than Meets the Eye

Think about your own most recent day at the office, and try to recall it in some detail. What would hidden observers have been able to learn had they been watching you go through that day? They might have read e-mails you composed, looked over the numbers you plugged into spreadsheets, reviewed the reports you prepared. They would have noted your interactions, in formal meetings or hallway encounters, with colleagues, subordinates, and superiors and listened in on a presentation you delivered. They would have heard your end of various telephone conversations, perhaps with customers, suppliers, or consultants. Maybe they would have

happening and what it means; *emotions*, whether sharply defined reactions (such as elation over a particular success or anger over a particular obstacle) or more general feeling states, like good and bad moods; and *motivation* – your grasp of what needs to be done and your drive to do it at any given moment. Inner work life is crucial to a person's experience of the workday but for the most part is imperceptible to others. Indeed, it goes largely unexamined even by the individual experiencing it.

In order to study inner work lives, we needed a level of access beyond that of an observer. Thus, we relied on the classic form of the personal diary. Every day, we sent a standard e-mail to every participant requesting a brief description, for our eyes only, of an event that stood out in his or her mind from that workday. (See the sidebar "How We Studied State of Mind" for more details on the study.) Their remarks tended to make clear what they thought of the event – what it said to them about their work, their team, their organization, or themselves – and how it made them feel. Beyond that, we had participants rate themselves and each of their teammates monthly along various dimensions (creativity, work quality, commitment to the work, and contributions to team cohesiveness). Because whole teams participated in the study, we were able to triangulate responses from colleagues, strengthening our understanding of notable events and their effects. Finally, rather than relying solely on a team's diaries to assess its overall performance, we also included evaluations by knowledgeable people outside the team.

Teresa M. Amabile is the Edsel Bryant Ford Professor of Business Administration at Harvard Business School, in Boston. Steven J. Kramer is an independent researcher and writer, based in Wayland, Massachusetts.

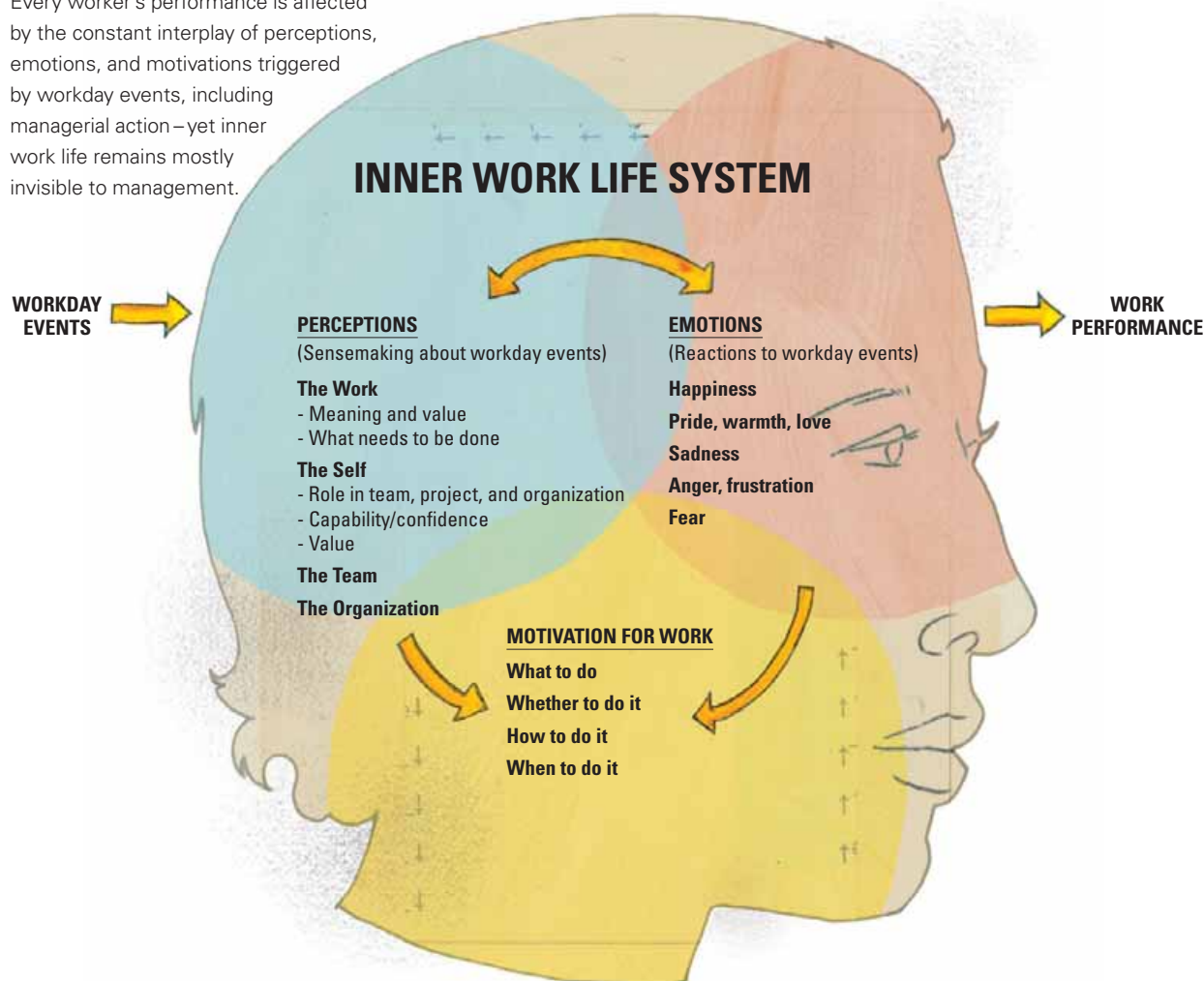
We were immediately rewarded with evidence of the richness and intensity of people's inner work lives and the proof that they were influenced strongly by the events of the day. What also emerged over time was evidence of the interplay among perceptions, emotions, and motivations – an inner work life system (See the exhibit “Processing Work Events: What Happens Inside.”) This discovery fits well with what is already known about the human brain. Recent research in neuroscience has found that emotion and cognition (which includes perception of events) are tightly intertwined. Areas of the brain associated with rational thought and decision making have direct connections to areas associated with feelings. They do not exist in separate psychological compartments, and they interact in complex ways. Like any system,

the brain cannot be understood simply by looking at each individual component. Inner work life functions the same way: It is crucial to consider all components and their interactions.

When something happens at work—some workday event—it immediately triggers cognitive, emotional, and motivational processes. People's minds start “sensemaking”: They try to figure out why the event happened and what its implications are. These perceptions feed the emotions evoked by the event, and the emotions, in turn, feed the perceptions. Depending on what happens with these cognitive and emotional processes, motivation can shift, which, in turn, affects how people perform their work. We discerned these processes in the diaries of every team we studied and in most of the people who worked on those teams.

Processing Work Events: What Happens Inside

Every worker's performance is affected by the constant interplay of perceptions, emotions, and motivations triggered by workday events, including managerial action—yet inner work life remains mostly invisible to management.



Consider how the dynamics played out with Infomap, a nine-person team of information technologists at Data-Brook, a subsidiary of DreamSuite Hotels, that we tracked through various projects across a five-month period. (We have disguised all names and other identifying information about the people and their company.) One urgent project, dubbed the “BigDeal” project, came up suddenly in the fourth month of our study and had enormous financial implications. DreamSuite was being sued for more than \$145 million, and its legal department required a great deal of analysis of financial records in order to defend the company. Infomap had eight days to complete the work.

Perception. As the diary entries shown in the exhibit “The Reality Management Never Sees” reveal, the project had significant effects on the inner work lives of the team members. What first becomes clear in studying the diary entries is that people’s “events of the day” caused them to form perceptions. Clark’s diary entry for May 26, for example, describes the start of the project and the activity surrounding it. Clearly

important and valued, which evoked additional positive emotions. Similar emotions arose when other colleagues and teams offered to pitch in, reinforcing the positive perceptions that team members had formed of those people – and leading, over time, to even more positive emotions.

Motivation. High levels of motivation are also on display in the BigDeal project diaries. The entry by Marsha on May 27, for example, reveals that she has just worked 15 hours straight. Yet she describes what she’s just endured as “one of the best days I’ve had in months!!” She notes, in that entry, that “our entire office worked like a real team” and referred to their work as the “big project.” Her previous diary entries allowed us to understand how her motivation on May 27 resulted from positive emotions and perceptions. We found, in those entries, that she often felt elated when the team worked closely together, and she perceived herself and her work as more valued when others in the organization signaled its importance. These effects of emotion and perception on motivation make perfect sense. If people are sad or

Most managers are not in tune with the inner work lives of their people; nor do they appreciate how pervasive the effects of inner work life can be on performance.

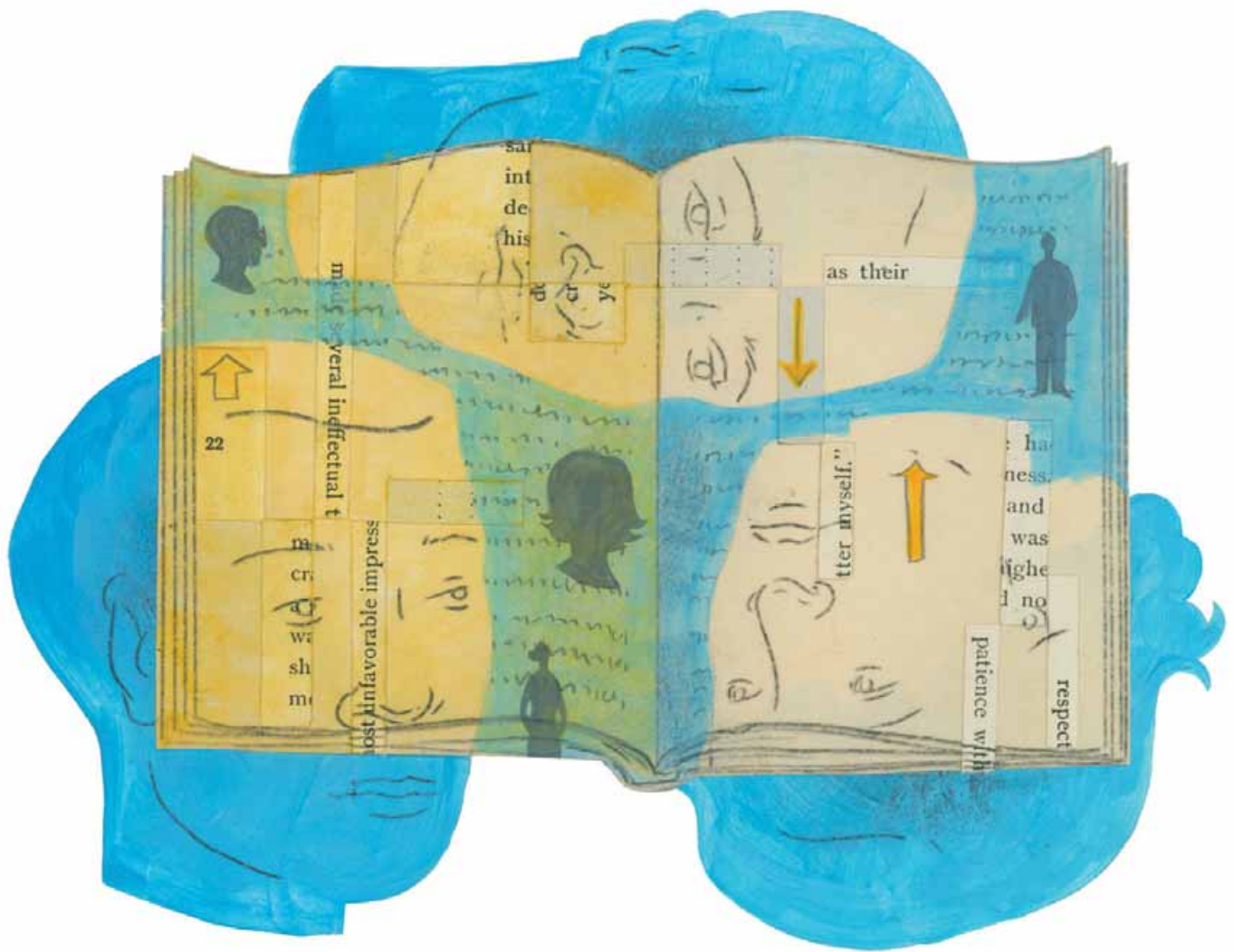
he is engaging in sensemaking, and he comes away with positive perceptions of the “extreme importance” of the work done in his office, the “problem-solving capability” of his team, and the “supportive” nature of management. We see the same kind of reflection by Chester as the project winds up on May 31. His sensemaking produces positive perceptions of the team’s coleader (Ellen), the team itself, other groups in the organization, and top management. These perceptions were triggered by specific events—for example, the extraordinary efforts of Ellen, who rolled up her sleeves and worked alongside the team.

Emotion. We also see the impact of daily events on people’s emotions. Helen is inordinately pleased when an upper manager brings refreshments to the team. Marsha reacts to an example of outstanding teamwork with great pleasure. The work atmosphere on May 31 is “happy and light,” she notes – even though they were working on Memorial Day, which should have been a holiday for everyone. Chester’s upbeat emotions on May 31 are likewise unmistakable.

There is evidence, too, even in the span of these few diary entries, of interplay between perceptions and emotions. When a high-level executive delivers bottled water and pizza to the people working after hours, not only does the event cause happy surprise, it also sends a real signal to the workers. That seemingly trivial event caused people on the BigDeal project to perceive their work and themselves as im-

portant and valued, which evoked additional positive emotions. If they are happy and excited about it, they will leap to the task and put great effort behind it. The same goes for perception. If people perceive the work, and themselves, as having high value, their motivation will be high. Just as important, if they perceive a clear path forward, with little ambiguity about what will constitute progress, motivation levels rise. The BigDeal project had all this going for it. People felt highly valued and certain about what needed to be accomplished. Ultimately, this translated to high performance on the project. Not only did the team get the work done on time, but its high quality made an immediate and measurable contribution to the company’s success.

The BigDeal project is all the more striking in comparison with the other projects we tracked for this team. In other periods, we were able to see the same inner work life system operating – but in much less positive ways. Despite the experiences during the BigDeal project, all was not rosy between the team and upper-level management. When, early in our study, an acquisition was announced, employees interpreted the event as a hostile takeover and reacted to it emotionally. Diary entries during that time used terms like “boneheaded” and “bigoted bunch of plantation owners” to describe top management. When layoffs were announced after the acquisition, the entire team perceived the process as unfair. They expressed considerable fear and anger in their diaries and



a markedly decreased level of motivation (“People are walking around scared and afraid for their jobs” and “What kills me is, after this, they will turn around and wonder why everyone doesn’t just throw themselves in front of a train for the company...what dopes”). In fact, during the entire time we studied the team – with the exception of the BigDeal project – the team members perceived their company’s executive leaders as aloof and oblivious to the team’s good work and reacted with varying levels of sadness, anger, and disgust.

Were managers aware of the team’s intensely positive perceptions, emotions, and motivations during the BigDeal project? Were they aware of its extremely negative inner work life at other times? Maybe. But when we met with the team, they made it clear that they generally displayed their emotions and described their perceptions only to each other or kept them entirely private. Our research suggests that most managers are not in tune with the inner work lives of their people; nor do they appreciate how pervasive the effects of inner work life can be on performance.

What Gets Done When People Have Good Days?

There is a long-standing debate among management scholars on the question of how work performance is influenced by people’s subjective experiences at work. One side says that people perform better when they are happier and internally motivated by love of the work. Others assert that people do their best work under pressure and when externally motivated by deadlines and competition with peers. There is research evidence to support each of these positions.

Having taken a microscope to this question, we believe strongly that performance is linked to inner work life and that the link is a positive one. People perform better when their workday experiences include more positive emotions, stronger intrinsic motivation (passion for the work), and more favorable perceptions of their work, their team, their leaders, and their organization. Moreover, these effects cannot be explained by people’s different personalities or backgrounds – which we did account for in our analyses. Put simply, every moment that they are performing their jobs, employees are “working under the influence” of their inner work lives.

The Reality Management Never Sees

Most managers are unclear about what is going on in their employees' inner work lives and have even less of an idea of what events affect them. Consider these diary entries by the Infomap team at DataBrook, a subsidiary of DreamSuite Hotels. (We have disguised all names and company information. We've also edited the diary entries slightly for clarity and brevity.) This nine-person team of information technologists was tapped to work on an urgent assignment, dubbed "BigDeal," that had enormous financial implications. DreamSuite was being sued for more than \$145 million, and its legal department required a great deal of analysis of financial records in order to defend the company. Infomap members worked long hours throughout the eight days they had been given to complete the project, including over a holiday weekend. Yet their spirits were remarkably upbeat. What was causing such a positive outlook despite the burdensome workload and schedule?

DataBrook upper management, which generally paid little attention to Infomap, spent time in the Infomap work area, checked frequently on the project's status, held back all other demands on the team's time, and provided encouragement and support in a number of small ways. Other groups within the organization cheerfully pitched in as needed. Ellen, the project manager and team coleader—who was recovering from surgery—not only did a great deal of the actual work but also served as a liaison between the team, upper management, and the internal clients. At the project's completion, although exhausted from the final five-day (and night) sprint, the team members were happy and pleased with the experience.

Clearly, management's engagement and behavior—even seemingly trivial and routine actions—made the difference. The diary excerpts tell the tale in people's own words.

Tuesday

I was called in to work on the BigDeal project. So DreamSuite has to go to court. So Big Deal. What about my vacation?

I'm angry about being called in. But I think I did some really good work under the pressure. And I feel that I really supported the team. **HELEN**

TEAM MEMBER IS CALLED
IN FROM VACATION

MAY 25TH

PROJECT
KICKOFF

Wednesday

Today's significant team event was one that Tom and I were not involved in. Our office has been asked to produce some ad hoc data...[for the BigDeal project]. Our director, manager, and many users have been in the office all day to monitor our progress, while Ellen called Helen in from vacation to help address the problem. **While I was not involved, I've made this my event for the day because I was able to witness the extreme importance of the financial data that we handle in this office, the problem-solving capability of my team, and the supportive involvement of our immediate management.** It was a very positive experience. **CLARK**

Wednesday

More work today on the big DreamSuite lawsuit problem.

The boss's boss came by to offer encouragement. That was nice. He bought us bottled water! Not the cheap stuff I buy, either.

We are getting tired! Nobody's snapped yet, though. I have to admit that I love working under pressure.

HELEN

Thursday

Hellzapoppin' around here the last week or so[...] People are working crazy hours, vice presidents are a dime a dozen in our office, and wonderful Miss Ellen is doing a great job keeping us going and still finding time to make a dozen status reports a day to every one of the VPs pestering her. Short-term, it's killing our productivity, but long-term, **Ellen is getting exposure under fire to some corporate bigwigs, which will enhance her career (and ours too,** by association, I suppose). **TOM**

SENIOR MANAGEMENT VISITS
PROJECT TEAM

MAY 27TH

Thursday

We seem to be wearing down! My part of the project is almost finished – Thank God! Tonight's reward from the boss's boss – more bottled water and pizza! **HELEN**

Thursday

Today **our entire office worked like a real team again.** It was wonderful. We [...] have all worked around the clock to get a big project done. I have been here about 15 hours, but **it has been one of the best days I've had in months!!**
MARSHA

Monday

I believe that the sense of accomplishment we felt after interacting so greatly throughout this entire ordeal is an event in itself.

From 05/25 through 05/30, I put in over 70 hours of work, and some other team members did the same – including Ellen, which was a constant worry for us due to her health. However, as usual, she was great. We ran into all sorts of unexpected problems and had to make all kinds of decisions. Several times, when we thought it was done, we would find a problem with the data, and sometimes almost start it all over again[...] This involved at least 5 members of our team, who worked around the clock, giving up holidays and even vacation.

It also involved people from other teams who were willing to help us (with a smile on their faces!), and what a fantastic help it was. Looking on the bright side of things, this not only brought our team even closer, but our efforts were noticed by several other teams and top management as well, having them here with us over the weekend for support to the point of going out of their way to bring us food. **CHESTER**

MAY 31ST
MEMORIAL DAY

Monday

I have been working straight through since Friday morning with just 7 or 8 hours off for sleep...I guess that's my event. I have been here with my project manager and one other team member. **I worked 14 hours Friday, 14 hours Saturday, 14 hours Sunday, and it looks like I will be here till midnight or later tonight.** The people I have been working with are wonderful, and **even though the hours have been stressful, the atmosphere has been happy and light.**
MARSHA

Tuesday

Today my project manager attended a meeting at 9 AM to report to DreamSuite marketing the extraordinary efforts of our team over the last 5 days. We have worked 14 hours a day since last Thursday in order to attend to two major problems. The meeting went well and they commended our team effort. Today I get to go home at my normal time and work my normal hours. **The last 5 days are a blur and I am exhausted, but overall I'm feeling pretty good.**
MARSHA

PROJECT MANAGER REPORTS
TO DREAMSUITES

JUNE 1ST

PROJECT
COMPLETION

Tuesday

Today, Ellen met with 20 to 30 people from DreamSuite Legal, DreamSuite Marketing, and DataBrook management to report the successful results of that activity. **When she returned, exhausted but happy, she told the worker-bees how well they had done, and we all applauded them.** Then she went home to get some sleep. **TOM**

So what do we mean by performance as it relates specifically to knowledge work? In settings where people must work collaboratively to solve vexing problems, high performance depends on four elements: creativity, productivity, commitment, and collegiality. We looked at each of these—using quantitative data from the monthly team ratings and the daily diary forms, as well as content analysis of the diary narratives—and mapped them against the three components of inner work life.

First, we traced the influence of positive emotion on people's creativity—that is, their ability to come up with novel and useful ideas. Many previous studies, conducted as carefully controlled laboratory experiments, have demonstrated a causal relationship between emotion—also termed “affect” or “mood”—and creativity. Our diary study, which used real-world settings and a more naturalistic approach to measuring the effect of emotion on creativity, confirms that this is not merely a laboratory phenomenon. Positive emotion was tied to higher creativity, and negative emotion was tied to lower creativity. Across all 26 teams, people were over 50% more likely to have creative ideas on the days they reported

evaluate and develop new ideas fairly, clearly focused on an innovative vision, and willing to reward creative work. They were less creative when they perceived political infighting and internal competition or an aversion to new ideas or to risk taking.

Finally, we analyzed the impact of motivation, the third aspect of inner work life, on creativity. Over the past 30 years, we have garnered a great deal of research evidence supporting what we call the intrinsic motivation principle of creativity: People are more creative when they are motivated primarily by the interest, enjoyment, satisfaction, and challenge of the work itself—not by external pressures or rewards. Most of this evidence comes from laboratory experiments. When intrinsic motivation is lowered, creativity dips as well. Our diary data add to the evidence. Our study participants were more creative in their individual work on the days when they were more highly intrinsically motivated. What's more, the projects distinguished by the greatest levels of creativity overall were the ones in which team members displayed the highest intrinsic motivation in their day-to-day work.

When we compared people's best days with their worst, the most important differentiator was being able to make progress in the work.

the most positive moods than they were on other days. This finding is based not on people's self-ratings of creativity but on evidence in the diary narrative that they actually did creative thinking that day.

There was even a surprising carry-over effect. The more positive a person's mood on a given day, the more creative thinking he or she did the *next* day—and, to some extent, the day after that—even taking into account the person's mood on those later days. This was clearly the experience of Marsha on the Infomap team. Of her 68 diary entries, 20 contained evidence of creative thinking. Fully 80% of those creative-thinking days followed days on which Marsha's general mood was higher than average for her. Her negative emotions on the days preceding creative-thinking days were the mirror image. Her anger was below average on 75% of the preceding days, her fear was below average on 65%, and her sadness was below average on 60% of them.

Second, we looked at how people's perceptions of their work context affected creativity. Again, our diary study adds more detailed evidence to previous research findings. People in our study were more creative when they interpreted the goings-on in their organizations in a positive light—that is, when they saw their organizations and leaders as collaborative, cooperative, open to new ideas, able to

Our findings were quite similar when we shifted our focus from creativity to the other elements of performance: productivity, commitment to the work, and collegiality (specifically, contributions to team cohesiveness). People performed better on all these fronts when they were in a good mood and worse when they were in a bad mood. Productivity, commitment, and collegiality also increased when people held positive perceptions about their work context. At a “local” level, this meant perceiving that they were supported by their team leaders and colleagues, creatively challenged by their tasks, trusted to make decisions with reasonable autonomy, and given sufficient resources and time to complete assignments. More broadly, it meant they perceived the organizational context as collaborative and open, not rife with political game playing or crippling conservatism. Finally, intrinsic motivation levels predicted performance levels across the board. People were more productive, committed, and collegial when they were more motivated—especially by the satisfactions of the work itself.

Clearly, inner work life matters to performance—how creatively people will think, how productive they will be, how much commitment they will show to their work, how collegial they will be. And many of the events that shape inner work life are caused, directly or indirectly, by managers.

What Good Management Does

When we ask people in business to guess which events caused by managers have the greatest influence on inner work life, they often think of interpersonal events—the kinds of person-to-person encounters where, for example, the manager praises a subordinate, works collaboratively with a subordinate as a peer, makes things more fun and relaxing, or provides emotional support. Or the opposite. These sorts of events do, indeed, have a real impact on people's perceptions, emotions, and motivations. Recall what a difference they made to the BigDeal team.

But, interestingly, our research shows that the most important managerial behaviors don't involve giving people daily pats on the back or attempting to inject lighthearted fun into the workplace. Rather, they involve two fundamental things: enabling people to move forward in their work and treating them decently as human beings.

Enable progress. When we compared our study participants' best days (when they were most happy, had the most positive perceptions of the workplace, and were most intrin-

sically motivated) with their worst days, we found that the single most important differentiator was a sense of being able to make progress in their work. Achieving a goal, accomplishing a task, or solving a problem often evoked great pleasure and sometimes elation. Even making good progress toward such goals could elicit the same reactions.

Sometimes the successes were clearly important for the project. For example, when Louise (an Infomap software engineer coding a new version of a major program) solved a problem to bring her within reach of the goal, she wrote, "I figured out why something was not working correctly. I felt relieved and happy because this was a minor milestone for me. I am 90% complete with this version of enhancements." A few weeks later, she accomplished an important step on a different programming assignment: "Yippee! I think I completed part of a project that has been a pain in the butt! I am taking reports over to the user for their viewing pleasure." But even very mundane successes led to positive feelings. For instance, a diary entry by Tom, another Infomap programmer, said, "I smashed that bug that's been frustrating me for

How We Studied State of Mind

Ten years ago, we set out on a quest to understand what really happens at work. As psychologists, we were fascinated by the unexplored territory of day-to-day life inside organizations and, more specifically, inside the hearts and minds of the professionals working in those organizations. Our aim was to explore daily inner work life—the emotions, perceptions, and motivations that people experience as they react to and make sense of the events of their workdays—and how it affects performance. Our questions were basic: What affects a person's inner work life? Is there anything predictable about how it is shaped by specific events unfolding in the workday and by the organizational context? Does inner work life affect performance? We decided that the best way to get to the heart of these questions was to collect daily diaries from the people themselves.

Over a period of three years, we recruited 238 professionals from 26 project teams in seven companies and three industries to participate in our study. Over 80% of the participants were college educated, and all of the projects required complex, creative work for successful completion. Thus, the term "knowledge workers" fits our participants well. We e-mailed diary forms to the participants every day (Monday through Friday) during the entire course of their projects, asking them each to complete the forms privately at the end of the workday. The average project length was a bit over four months, but some were as long as eight or nine months. About 75% of the forms were returned to us

completed and on time, yielding nearly 12,000 individual diary reports.

The diary form had several numerical questions, asking participants to rate their own perceptions of various aspects of the work environment, their mood, and their motivation that day, as well as their own work and the team's work that day. There was also an open-ended question asking people to list the main work tasks they engaged in that day. The most important question was also open-ended; it asked people to briefly report one event that stood out in their minds from the workday.

Although this question simply asked for an event—a concrete description of something specific that happened and who was involved—we found that, very often, people didn't stop there. They told us, sometimes in great detail, about their perceptions of the event and the thoughts that it engendered. They told us about how the event made them feel. And sometimes they told us how it affected their motivation and performance that day. These were the data that led to our primary discoveries of how constant and pervasive inner work life is and how it operates as a complex system. Together with the numerical data we collected on the diary forms and many other sources of data on the participants, the teams, the projects, and the companies, the daily diary narratives served as the basis for our conclusions about inner work life, what affects it, and how, in turn, inner work life affects performance.

almost a calendar week. That may not be an event to you, but I live a very drab life, so I'm all hyped." This is the kind of joy that people feel when they can simply accomplish what they need to.

Not surprisingly, there is a flip side to this effect. Across our entire database, the worst days—the most frustrating, sad, and fearful days—were characterized by setbacks in the work. Again, the magnitude of the event is not important: Even seemingly small setbacks had a substantial impact on inner work life. On April 19, Tom's failure to make measurable progress in his work cast a pall on his day: "No event today, just the continuing frustration of the week—trying to install a fairly simple change in code to an enormously complicated method of installation and production execution. Honest, you don't want to hear the details." On April 12, Louise reported being irritable about an obstacle she couldn't get around. "I changed a program today and got a syntax error....I was angry with myself."

It was clear from the diary data that being able to make progress in the work is a very big deal for inner work life. The next question, then, is which managerial behaviors affect

team's clients about their needs and expectations. This clarity was sometimes hard to come by, and, in those instances, progress was impeded. Consider the following example, in which a client had requested a software development project with a firm deadline but with little more than a vague sense of what the final computer program was supposed to do. Repeatedly over several days, Ellen contacted the client manager to discuss specifics. Repeatedly, she was brushed off. Marsha, to whom Ellen had assigned the project, wrote in her April 6 diary:

We had a meeting to discuss the CRR project that I have been working on; the meeting was with just Ellen and Helen. The users have never given us written requirements for the project, and yet they just sent us a note asking if we will make the May 6 deadline. I am just forging ahead and coding like crazy...here's hoping they like what they never have asked for. Ellen is trying very hard to get them to commit themselves.

Eventually, Ellen did manage to get specifications from the client team's manager, and, with a Herculean effort, Marsha did succeed in getting the project done well and on time.

Because every employee's inner work life system is constantly operating, its effects are inescapable.

employees' ability to do so. Our research points to several: for example, providing direct help (versus hindrance), providing adequate resources and time (versus inadequate resources or unnecessary time pressure), and reacting to successes and failures with a learning orientation (versus a purely evaluative orientation). But one of the most important managerial behaviors turns out to be the setting of clear goals. People make more progress when managers clarify where the work is heading and why it matters. In our diary study, the teams that made greater progress had more events in which the project goals and the team members' individual work goals were clear or were changed carefully and where people knew why their work mattered to the team, the organization, and the organization's customers. By contrast, teams that made less progress reported more events that muddled, confused, or haphazardly changed the goals. Sometimes those teams would be given a goal by management, only to be assigned several other tasks that conflicted with that goal. Often, those teams had a sense of futility about their work, because of uncertainty about how or even whether their efforts would make a difference.

The people on the Infomap team generally made good progress in their work—on the BigDeal project and others—and it was primarily because Ellen, the project manager and one of the team's leaders, relentlessly sought clarity from the

But all of Marsha's hard work before the specifications were nailed down was relatively directionless and based on supposition, which impeded both real progress and her own sense of accomplishment. By contrast, during the BigDeal project, the managers who needed the work done communicated in detail with Ellen from the outset to clarify the project goals, specify their needs, and explain to everyone involved why the project was so important. Although there were many technical problems to overcome, there was no ambiguity about the goal. The effects on progress were dazzling.

Managerial events facilitating or impeding progress may be so powerful because they have multiple direct and indirect effects on performance. The direct effects are fairly obvious. For example, when goals are not articulated clearly, work proceeds in wrong directions and performance suffers. Less directly, the frustration of spinning one's wheels sours inner work life, leading to lower motivation; people facing seemingly random choices will be less inspired to act on any of them. And there is a further effect. When a manager's actions impede progress, that behavior sends a strong signal. People trying to make sense of why higher-ups would not do more to facilitate progress draw their own conclusions—perhaps that their work is unimportant or that their bosses are either willfully undermining them or hopelessly incompetent.

Manage with a human touch. None of this emphasis on the managerial behaviors that influence progress diminishes the importance of the interpersonal managerial events that we mentioned earlier—events in which people are or are not treated decently as human beings. Although such events weren't quite as important in distinguishing the best days from the worst days, they were a close second. We frequently observed interpersonal events working in tandem with progress events. Praise without real work progress, or at least solid efforts toward progress, had little positive impact on people's inner work lives and could even arouse cynicism. On the other hand, good work progress without any recognition—or, worse, with criticism about trivial issues—could engender anger and sadness. Far and away, the best boosts to inner work life were episodes in which people knew they had done good work and managers appropriately recognized that work.

...

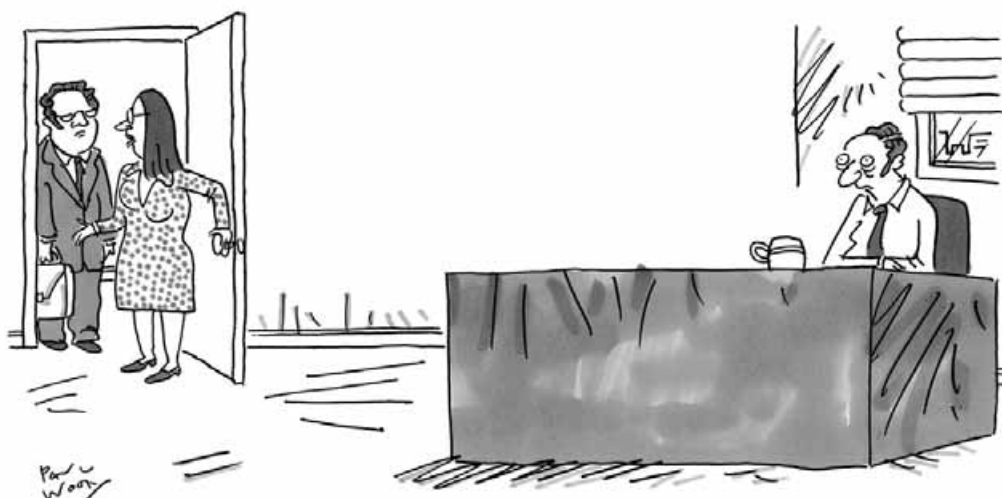
Peter Drucker once wrote, "So much of what we call management consists of making it difficult for people to do work." The truth of this has struck us as our ongoing analyses reveal more of the negative managerial behaviors that affect inner work life. But we have also been struck by the wealth of managerial opportunities for improving inner work life. Managers' day-to-day (and moment-to-moment) behaviors matter not just because they directly facilitate or impede the work of the organization. They're also important because they affect people's inner work lives, creating ripple effects on orga-

nizational performance. When people are blocked from doing good, constructive work day by day, for instance, they form negative impressions of the organization, their coworkers, their managers, their work, and themselves; they feel frustrated and unhappy; and they become demotivated in their work. Performance suffers in the short run, and in the longer run, too. But when managers facilitate progress, every aspect of people's inner work lives are enhanced, which leads to even greater progress. This positive spiral benefits the individual workers—and the entire organization. Because every employee's inner work life system is constantly operating, its effects are inescapable.

Discovering how inner work life affects organizational performance is clearly valuable. But as researchers we hope we have also made progress on another front. Inner work lives matter deeply to the people living them. Studies of the modern workweek show that knowledge workers today, as compared with workers of past eras, spend more time in the office and more time focused on work issues while outside the office. As the proportion of time that is claimed by work rises, inner work life becomes a bigger component of life itself. People deserve happiness. They deserve dignity and respect. When we act on that realization, it is not only good for business. It affirms our value as human beings. 

Reprint R0705D

To order, see page 147.



"The caffeine has kicked in. You've got 20 minutes."

The most attractive markets are almost always the hardest to profitably break into. The trick is to be indirect, so incumbents don't notice you until it's too late.

BY DAVID J. BRYCE AND JEFFREY H. DYER

STRATEGIES TO CRACK WELL-GUARDED MARKETS

WHAT'S THE SMARTER STRATEGY: To break into an industry where, judging by the incumbents' performance, you can make only average profits but are likely to do so? Or to jump into a market where you might make above-average profits but are unlikely to do so? The right choice isn't obvious, but most companies prefer to enter industries where the existing players' profits are consistently higher than those of enterprises in other industries. Entrants know they'll have to take on powerful incumbents, but because of the large profit margins, they're drawn to those markets like bees to a honey pot.

Beppe Giacobbe



Companies forget, however, that it's tough for new ventures to make money in profitable markets. If it weren't, many others would have already entered those industries, competition would be perfectly fierce, and everyone's profits would tumble. As Harvard Business School's Michael Porter pointed out in "How Competitive Forces Shape Strategy" (HBR March–April 1979), incumbents earn relatively high profits only because of special circumstances, such as their bargaining power over suppliers and buyers, the lack of substitute products, favorable competitive conditions, or, crucially, barriers to entry. Unattractive markets are, well, unattractive, but attractive markets are a conundrum: You can look longingly at them, but you can't enter them easily, because of barriers erected by market leaders.

Sure, CEOs believe that they can buy their way into profitable markets. However, mergers and acquisitions are fraught with peril because corporate raiders end up paying for target companies' present and future profit streams. The premiums that buyers pay for acquisitions' stock average

Their returns were nearly seven times those of all entrants in the top industries—and almost four times the returns of the profitable entrants in less attractive markets. Just how did those companies manage that?

The Importance of Indirect Assault

When we dissected the strategies that companies have used to overcome entry barriers, one common theme stood out: indirect assault. Smart newcomers refuse to challenge incumbents on the latter's terms and turf. They don't duplicate existing business models; they don't compete for crowded distribution channels; and they don't go after mainstream customers—at least not at first. Almost without exception, the challengers take a page out of the military handbook: Never attack the enemy in its strongholds initially. Attack at its weakest points, gain competitive advantage, and later, if doing so meets your objectives, attack its strongholds. Successful entrants don't engage in frontal attacks, because mar-

WHEN companies use strategies that incumbents either find difficult to respond to or choose to ignore, their chances of success rise exponentially.

about 30%, and buyers' shareholders typically lose value in the process. That raises the question, Are there ways by which companies can profitably enter attractive markets?

Despite the wealth of research on corporate strategy, we couldn't find any answers. So we decided to study enterprises that successfully entered the most profitable industries in the United States—measured by incumbents' returns on assets—between 1990 and 2000 (for details, please see the sidebar "About Our Research"). We also analyzed unsuccessful entrants in order to contrast their strategies with those of the winners. Our four-year study left us with no doubt that money attracts money. In the decade we examined, the most profitable industries had almost five times as many entrants as did the average industry. Most of those companies found the going tough, though. Fresh entrants in the most attractive markets earned returns that were 30% lower than those earned by newcomers in other industries. That said, when entrants in the top industries were profitable, they won big.

David J. Bryce (dbryce@byu.edu) is an assistant professor of organizational leadership and strategy, and Jeffrey H. Dyer (jdyer@byu.edu) is the Horace Pratt Beesley Professor of Strategy, at Brigham Young University's Marriott School of Management, in Provo, Utah.

ket leaders can head them off by cornering key resources or will stop them in their tracks with price wars, ad blitzes, lawsuits, and other retaliatory tactics. However, when companies carve out toeholds by using strategies that incumbents either find difficult to respond to or choose to ignore, their chances of success rise exponentially.

Two recent battles in the soft drinks and video games industries underline the importance of mounting indirect assaults. Everyone knows that the carbonated soft drinks industry is extremely profitable. The three companies that dominate the industry—Coca-Cola, PepsiCo, and Cadbury Schweppes—enjoyed gross margins of more than 60% and an average return on assets of 17% between 1990 and 2000. These profits persist even though an entrant can build a soft drinks concentrate plant big enough to serve all of North America for less than \$50 million. Moreover, with apologies to Coke lovers and Pepsi lovers, tests show that similar soft drinks, such as colas, aren't very different in taste. Even so, it has been virtually impossible for newcomers to break into the soft drinks industry because of three barriers: brands, bottling and distribution capabilities, and shelf space.

Against this backdrop, two European companies, Virgin Drinks and Red Bull, entered the U.S. soft drinks market in

The Three Basic Strategies

Smart companies use three fundamental approaches, usually combining at least two of them, to break into profitable markets.

1 LEVERAGE EXISTING ASSETS

Companies use what they already have, often supplementing their assets and resources with a partner's, to overcome entry barriers.

2 RECONFIGURE VALUE CHAINS

Entrants change the activities or the sequence of activities they perform to deliver value to customers.

3 ESTABLISH NICHE

Enterprises develop offerings with features that don't initially appeal to mainstream customers but attract customers in a fringe segment.

the late 1990s with vastly different strategies. In 1998, Virgin Drinks took Coca-Cola, PepsiCo, and Cadbury Schweppes head-on, launching its own cola, advertising heavily, and trying to get into all the retail outlets that stocked the leading brands. At Virgin Cola's U.S. launch, Virgin Group CEO Richard Branson drove a tank through a wall of cans in New York's Times Square to symbolize the war he wished to wage on rivals. However, the leaders' viselike grip on shelf space proved impossible for Virgin Drinks to break. In July 2000, the company's marketing vice president admitted to a trade publication that "there are people who are saying, 'We've been looking for years, and we can't find it [Virgin Cola].'" Although Virgin Drinks is still in the fray, it has never garnered more than a 1% share of the U.S. cola market.

Red Bull, by contrast, entered the U.S. soft drinks market in 1997 with a niche product: a carbonated energy drink retailing at \$2 for an 8.3-ounce can—twice what you would pay for a Coke or a Pepsi. The company designed its cans as narrow, tall cylinders, so retailers could stack them in small spaces. It started by selling Red Bull through unconventional outlets such as bars, where bartenders mixed it with alcohol, and nightclubs, where 20-somethings gulped down the caffeine-rich drink so they could dance all night. After gaining a loyal following, Red Bull used the pull of high margins to elbow its way into the corner store, where it now sits in refrigerated bins within arm's length of Coke and Pepsi. In the United States, where Red Bull enjoyed a 65% share of the \$650 million energy drink market in 2005, its sales are growing at about 35% a year. Red Bull is privately held, but all the signs suggest that it's profitable.

In like vein, compare the strategies that Microsoft and Jakks Pacific used to break into the enormously profitable video game industry. Microsoft's Xbox, launched in 2001, is a direct assault on industry leaders Sony and Nintendo. Five years and approximately \$4.5 billion in losses later, the Xbox had a 15% share of the console market, compared with Sony's 69% share. Between 2002 and 2006, Nintendo and Sony earned operating profit margins of 20% and 8%, respectively, while Microsoft incurred a margin of -30%, according to our calculations. Despite losses that would have devastated most companies, Microsoft has stayed in the industry, thanks to the profits from its other businesses. Sure, the Xbox business may become profitable one day, but based on 2006 figures, even if Microsoft had achieved Sony's profitability level in 2006, it would need more than 12 years to cover its past losses.

By contrast, California-based toy and action figure manufacturer Jakks Pacific, whose Toymax division entered the video game industry at the same time as Microsoft, has avoided confronting Sony and Nintendo. The company embeds video games into a \$20 game controller that plugs into TV sets. It offers games based on characters, movies, and video games developed by well-known companies such as Atari, Disney, Electronic Arts, Hasbro, and World Wrestling Entertainment. Jakks Pacific's target segments are preteen kids and price-conscious adults. Although the quality of its games doesn't compare with that of the leaders', they're colorful, portable, and inexpensive. According to our estimates, between 2003 and 2005, the company's sales of plug-and-play games increased by about 25% a year, and its revenues more than doubled, from \$316 million to \$661 million. Its games division boasts operating profit margins of roughly 15%, and its operating profits rose from \$11 million in 2003 to \$97 million in 2005—profitability that Microsoft's Home and Entertainment Division would probably envy.

The Power of Combination

Indirect assault is the leitmotif of successful entries into attractive industries, especially when companies haven't developed technological innovations. However, working out how to mount such attacks is tough. Successful companies use three basic approaches. First, they leverage their existing assets and resources. They use their excess capacity, often combining it with partners' assets or resources, to lower the cost of entering new markets. For instance, a company may place a new product in shelf space it already owns or manufacture goods with machines that would otherwise be idle. Second, companies reconfigure their value chains by changing the activities or the sequence of activities they perform. They borrow elements from other industries or use technological advances to create value chains that differ from those of incumbents. When a company bypasses bricks-and-mortar retail outlets and sells its products through a Web site, for example, it is

reconfiguring the industry's value chain. Third, enterprises create niches by developing offerings that appeal only to some customers. That can mean offering premium features at a price that only certain consumers are willing to pay or dropping features that some people don't care to pay for.

The three basic approaches may appear to be simple, even commonplace. The magic, however, lies in their combination. Successful companies mix and match the three approaches, deploying at least two of them simultaneously or sequentially. By creating powerful combination strategies, enterprises can defy half a century of economic logic and make money by entering highly profitable industries.

Reconfigure the value chain and create a niche. This is, arguably, the most powerful combination strategy. By reconfiguring value chains, entrants create low-cost business models; at the same time, by establishing niches, they stay off incumbents' radar screens. The disruption approach that Harvard Business School's Clayton Christensen described in *The Innovator's Dilemma* is one of the better-known examples of this genre. Innovators enter the market with inferior products

the challenger has reconfigured the value chain dramatically. It targets cost-sensitive buyers who care little about the inconvenience or poor quality associated with using a computer as a telephone. At one stage, the telecom giants ignored the interloper, possibly viewing it as just another dot-com offering a software package with free downloads that would soon go bust. This gave Skype the time it needed to build scale and credibility. Founded in August 2003, the upstart was picked up by eBay two years later for \$2.6 billion. Skype reported revenues of \$25 million in 2005, and by December 2006, the company claimed to have more than 100 million customers, which suggests that it may be turning into a dangerous rival faster than incumbents realize.

Companies needn't always use low-cost disruption to succeed with this combination strategy. Sometimes, reconfigured value chains can generate both higher costs and higher returns. For example, in 1992, Salt Lake City-based Usana Health Sciences entered the nutritional supplements niche of the pharmaceuticals industry. To take on incumbents such as GNC, Usana has reconfigured the value chain in two ways.

THE three basic approaches to entering attractive markets may appear to be simple. The magic, however, lies in their combination.

that appeal mostly to price-sensitive buyers; incumbents ignore the threat, since mainstream customers don't want those products; and over time the products improve and take large chunks of the market from incumbents. Market leaders can't respond, because they find it difficult to replicate entrants' low-cost business models.

This combination strategy often allows newcomers to get over their teething troubles easily, because incumbents find it pointless to strike against them. For one thing, challengers' offerings appear different enough that incumbents may not realize that they have competition. For another, the entrants don't initially target existing players' best customers. Only in the long run do challengers enhance their capabilities and take away more profitable customers. Consider, for instance, the telecom services industry, which was highly profitable until deregulation led to overcapacity and a shakeout in the 1990s. It's still a tough market to get into because of government regulations and the amount of capital that the business demands. While telecom giants such as AT&T–Cingular, Sprint, and Verizon use fiber-optic cable networks and telephone instruments to provide consumers with plain old phone services, Skype lets people make inexpensive calls over the Internet. By using the Internet, microphones, and computers,

First, it uses processes similar to those that pharmaceutical companies deploy in order to develop new products. Second, instead of selling through retail outlets, Usana has created a global network marketing organization of 140,000 distributors. That has made it difficult for incumbents to respond. Usana's sales have grown at about 15% per year to almost \$400 million in 2006. With an average return on capital of nearly 50% between 2002 and 2004, the company ranked third on *BusinessWeek's* list of "hot growth companies" in 2005.

Leverage existing assets and reconfigure the value chain. Fifteen years ago, Wal-Mart popularized this combination strategy. The company used its private label, Sam's Choice, and its shelf space to vault over the barriers that prevent companies from entering the soft drinks business. Realizing that it didn't have resources in product development and bottling, the retailer teamed up with Canada's Cott Corporation. A manufacturer of premium private-label products, Cott worked with Wal-Mart to develop a line of soft drinks that is an alternative to Coca-Cola and PepsiCo products. An important part of the duo's strategy was combining Cott's manufacturing operation with elements of Wal-Mart's distribution system to create a hub-and-spoke system, so they could get products into stores far cheaper than the incum-



bents could. Unlike the other manufacturers, Cott bottles Sam's Choice products centrally, which lowers costs. Instead of delivering to thousands of stores, Wal-Mart picks up the beverages and distributes them through its 35 distribution centers, which supply between 60 and 125 Wal-Mart stores each. The retailer doesn't sell Sam's Choice through grocery store chains, vending machines, or soda fountains—the leaders' most popular channels. By avoiding the stiff competition for those outlets, Sam's Choice earns hefty margins within Wal-Mart's walls. These tactics also helped Wal-Mart prevent the counterstrategies that the incumbents would have deployed against a more direct attack. In 2004, Cott and Wal-Mart were named Beverage Forum Company of the Year and Beverage Forum Retailer of the Year, respectively. By December 2006, Sam's Choice had wrested about 5% of the U.S. soft drinks market from the incumbents.

While Wal-Mart launched a low-cost private label, Costco used the same combination strategy to create an upmarket offering. A warehouse club that sells premium brands such as Polo, Cartier, and Waterford Crystal, Costco entered the home furnishings market by leveraging its brand and retail concept. By locating Costco Home stores in its existing markets, often near Costco Warehouse stores, and letting Costco's 20-million-plus members become members of the home stores, the company also used its customer base effectively. Its value chain avoids the fat—extravagant showrooms, plen-

tiful inventory, and huge commissions—that is usually associated with furniture retailing. For example, at a Costco Home store, the area covered per employee is three times that at an Ethan Allen store, demonstrating lower reliance on salespeople; the retailer doesn't spend much on advertising; and since its low prices help move products off the floor quickly, its inventory turnover rate is twice the industry average. These advantages give Costco a 15% to 25% cost advantage over incumbents such as Bassett Furniture, the Bombay Company, Ethan Allen, and Thomasville Furniture. The incumbents haven't copied Costco Home's moves, because they aren't familiar with the process of creating membership-only warehouses that offer premium products at a discount. This has given the newcomer time to consolidate its operations. While Costco was looking for \$40 million in revenues from its pilot Costco Home store in 2006, industry magazine *Furniture Today* estimates the revenues from the first two stores at \$108 million. Costco Home ranked 65th in U.S. furniture sales last year and earned profit margins that are comparable to those that Costco Warehouse earns.

Leverage existing assets and create a niche. Companies can use the elements of this combination strategy, like the other pairs, either simultaneously or sequentially. When Toys "R" Us entered the apparel industry in 1996 by opening its Babies "R" Us stores, for instance, it deployed both parts of the strategy at the same time. The retailer leveraged name

About Our Research

To study the most profitable U.S. industries, we started by identifying the primary industry for each of the 24,178 companies in the Compustat North America database. Compustat assigns every enterprise to the industry that accounts for the highest percentage of its revenues, using the four-digit classification codes published by the U.S. Census Bureau. We gathered data on each company's pretax profits and assets for every year from 1990 to 2000.

We then calculated the weighted average return on assets for industry incumbents by dividing the total pretax profits generated by the companies assigned to each industry during those ten years by the total assets deployed. This had the effect of normalizing cross-industry differences on returns relative to costs of assets deployed. After eliminating industries such as tobacco, where there was one incumbent, and investment advisory services, where incumbents' assets included clients' financial assets, we ranked industries based on ROA. The higher the ROA, the more attractive the industry. In the top ten industries, the average ten-year pretax return on incumbents' assets was 17.9% – 4.6 times higher than the average

3.9% return achieved in all other industries during the same period. The table shows the ten most attractive, or profitable, industries in the United States between 1990 and 2000.

We also used the Compustat database to identify companies that entered the ten most profitable industries in that decade. We examined each enterprise to determine whether it was new to the industry or had been misclassified. After we eliminated coding errors, our sample consisted of companies for which the attractive industry was the entrant's primary industry.

The data, however, didn't capture entrants such as Wal-Mart in soft drinks, because that isn't the retailer's primary industry. So we did a literature search on each industry and spoke with industry experts to identify additional entrants. We also identified notable entrants, such as private companies, that didn't appear in the public data set. This allowed us to develop a reasonably comprehensive list of entrants. Between 2003 and 2006, we wrote case studies on a large number of those companies. Doing so enabled us to identify the successful approaches that companies use to enter attractive markets.

Performance and Entry in the Ten Most Profitable Industries (1990–2000)

Industry	Incumbents' ROA	Number of Entrants	Rate of Entry	Entrants' ROA	Profitable Entrants' ROA
Software	21%	675	90%	–4%	14%
Research Services	20%	16	67%	12%	14%
Semiconductors	18%	141	74%	6%	11%
Athletic Footwear	18%	3	43%	–5%	5%
Apparel	17%	9	47%	16%	26%
Beverages	17%	6	67%	–1%	9%
Testing Laboratories	17%	6	60%	7%	11%
Credit Rating Agencies	16%	10	71%	19%	23%
Grain Mill Products	15%	15	68%	5%	5%
Sugar & Confectionary Products	15%	8	42%	–3%	10%
Average of Top Ten Industries	17.9%	89	85%	1.6%	11.1%
Average of All Other Industries	3.9%	19	70%	2.3%	3%

Incumbents are defined as companies that were in an industry for the entire decade. ROA averages (including those in the bottom two rows) are weighted by incumbent companies' assets from 1990 to 2000. Rates of entry—the number of entrants divided by the number of companies in the industry from 1990 to 2000—are weighted by the number of entrants.

recognition, store locations (most Babies “R” Us stores are situated next to Toys “R” Us stores), relationships with real estate developers, and its inventory management and distribution capabilities to go after the children’s product niche in the apparel industry. In contrast to Costco Home, Toys “R” Us didn’t alter the value chain; its supply chain and stores are similar to those of other retailers. However, by pursuing a niche that allowed it to leverage its existing resources, the company overcame opposition from well-entrenched rivals to become the largest baby products retailer in the world by 2006. Between 1996 and 2006, sales per Babies “R” Us store rose every year even as sales steadily declined at Toys “R” Us stores.

When newcomers establish niches before leveraging their assets, they can move into mainstream markets from secure beachheads. That’s what Skechers (also slang for “people who can’t sit still”) did in order to break into the shoe market. It started by offering a sport utility logger boot in 1993 and eased into the sneakers niche by serving a hip crowd with laceless pull-on, sling-back, and roller-skate sneakers. Once it had grown its organizational capabilities, Skechers leveraged them to expand into jogging and running shoes. Even when it moved into those markets, Skechers avoided taking on Nike, Reebok, and Adidas. It stayed out of retail chains like Foot Locker, which carry the Big Three, and didn’t pitch its shoes as performance sneakers. By 2005, Skechers’ sales grew to about \$1 billion, and the company reported a net income of \$45 million.

Incidentally, newcomers needn’t always have mainstream markets as their goal. If they do, they will run headlong into incumbents. Venturing out of a niche could also result in a loss of focus or the dilution of a carefully cultivated position on the fringe. However, when niches have been conquered and top management starts hunting for growth, most entrants will look to the mainstream.

Although companies usually deploy these strategies in pairs, a few have used all three approaches in tandem. Revisit Jakks Pacific’s strategy to enter the gaming market, for instance. First, in conjunction with several partners, the company leveraged brand capital from well-known TV programs and games to create new games. Second, it reconfigured the value chain by embedding software in the controller, as opposed to taking a components-based approach, and by directly licensing content from game owners. Third, Jakks Pacific targeted niche audiences such as young children, who find it difficult to cope with games for Sony’s Playstation 3 or Nintendo Wii. The three-pronged strategy explains why Jakks Pacific is thriving in the video game market, but we find that in most cases a two-pronged strategy works equally well.

Picking the Right Combination

The more indirectly a combination strategy attacks an incumbent, the more effective it is likely to be. How indirect it is will depend on the context—that is, on the entrant and the

industry. To choose the right combination, would-be entrants must figure out what impact each underlying approach would have on incumbents. They can tailor combinations to their assets and markets by asking themselves a few questions about their ability to use each type of strategy.

Can we reconfigure the value chain? Companies must rethink the traditional ways in which incumbents serve customers in order to reconfigure their value chains. They must ask themselves:

- Can we use new technologies, organizations, or countries to perform activities in this industry in ways that weren’t possible until recently? For instance, companies can now source products from China and services from India; they can buy designs from shops such as Ideo and Design Continuum; they can market products through webcasts, podcasts, Google, chat rooms, and e-mail; and they can rely on long-distance payment methods such as PayPal. That’s not what most incumbents have done.

- Can we apply a business model from another industry to this one? Netflix used that approach when it applied an Amazon-like model to DVD rentals.

- Can we modularize the existing value chain, either by recombining steps or by substituting ones from different value chains? Usana took this tack when it brought multilevel distribution to the nutritional supplements industry.

When newcomers reconfigure value chains, their costs usually fall below those of incumbents. That makes it possible for them to offer inexpensive, frills-free products, but occasionally, they leapfrog the performance of established products. That’s what Apple did when it created the iPod, which is a technologically superior MP3 player that relies on iTunes software for digital downloads. To be sure, newcomers violate the principle of indirect assault when they launch premium products, because those usually appeal to incumbents’ best customers. The challenger must therefore ensure that existing players find it almost impossible to imitate its value chain. Five years after Apple launched the iPod, it still dominates the industry because it has imposed switching costs by forcing consumers to use iTunes.

Can we find a niche? An entrant will be better able to create a niche if it can answer yes to the following questions:

- In this market, do customers care about a large number of features? If so, the entrant will be able to create products that boast new feature sets.

- Do customers vary significantly in their preferences? If they do, the entrant will be able to exploit the fact that there are several clusters of customers with similar tastes, but large differences between the clusters.

- Are there distinctive groups of customers who are not well served by current offerings? The simplest way to figure that out is to examine the established players’ biggest customers and then look for potential customers who aren’t like them.

- Are there rebel customers who, in an attempt to maintain a nonconformist identity, avoid mainstream products?

Skechers' "aha" moment came when it identified the laceless-sneaker crowd as a niche with nonmainstream needs. Those customers avoided Nike, Reebok, and Adidas products, perceiving them as uncool.

Can we leverage our assets and resources? Companies can tap underutilized resources to enter new markets only when the cost of doing so is relatively low. The resources can be tangible assets such as plant and equipment, distribution channels, retail outlets, and real estate. In fact, assets with high fixed costs are easy to leverage because the incremental cost of redeploying them is often low. Intangible resources such as brands, intellectual property, and know-how in design, manufacturing, or distribution have few capacity constraints. Companies can utilize brands and know-how in particular with almost no incremental cost and without worrying too much that they will be depleted. There are limits, though. For instance, a brand can be used to sell many different products,

for quick service to break into the fiercely competitive DVD rental market. McDonald's faces stiff competition from Hollywood Video and Blockbuster, but it offers a lower-cost item, since customers can rent DVDs for one night, not just for blocks of time such as two or four days. Last year, McDonald's spun out the subsidiary, in which it retains a 40% equity stake. Redbox has attracted fresh investors such as Coinstar and is expanding rapidly through McDonald's restaurants and grocery store chains all over the United States.

...

Companies that enter an attractive industry often wonder if they can close the door on the way in. It's important to do so, as Red Bull will vouch. Once energy drinks became popular and the market grew from \$12 million in 1997 to \$650 million in 2005, more than 150 me-too manufacturers entered the segment. One solution is for newcomers to go mainstream as soon as they have built the capabilities to battle incumbents.

WHEN entering an attractive industry, companies should try to close the door on the way in.

but most people wouldn't want to munch on Kleenex potato chips or to earn an MBA from Sam's Choice University.

Finding related businesses that aren't obvious to everyone is difficult but not impossible. One admittedly haphazard approach is to cull lists of related industries from the North American Industry Classification System that the U.S. Census Bureau publishes. Other tools include databases that can be used to identify overlaps in companies' patent classifications. More sophisticated approaches are emerging, as well. For example, Wharton School professor Sidney Winter and one of the authors of this article, David Bryce, developed an index that shows the degree of relatedness between any two industries along dimensions such as technology, distribution, and market similarity.

For a company to lower its entry costs, its capacity in its existing market must have relevance to activities in the target market. Entrants must look for subtle similarities between the existing and target markets' customers, channels, inputs, processes, or technologies. For instance, McDonald's cannily anticipated that at least some of its customers may be interested in renting DVDs. In 2004, it placed DVD rental kiosks in 100 of its restaurants in the Denver area. With the swipe of a credit card, customers could rent DVDs for \$1 a night. Once it had tested the idea, McDonald's created a subsidiary, Redbox, which set up kiosks in 800 McDonald's stores in six regional markets. The fast food giant has leveraged its excess capacity in stores, its numerous locations, and its reputation

By doing so, they create brand recognition and gain market share and volume, making it more difficult for copycats to survive. In the process, entrants cultivate new sources of growth and profits while fast followers attack their initial strategies. For example, by entering the athletic shoe business as soon as it had established itself in the sneaker market, Skechers quickly moved ahead of would-be followers.

Entrants can also create barriers by securing scarce inputs or locations for themselves, investing preemptively in capacity, generating network effects, or developing cost advantages by racing down the experience curve. For example, JetBlue was the first airline to offer satellite TV to passengers. To prevent imitation, the airline bought LiveTV, the company that developed the technology. Until recently, any airline that wanted to offer satellite TV to passengers had to purchase it from JetBlue. Similarly, when JetBlue saw an opportunity to serve midsize cities with a new 100-seat Embraer jet, it purchased the Brazilian aircraft maker's manufacturing capacity for two years. Later, the airline signed a contract with Embraer that prevented it from selling the jet at a price lower than JetBlue had paid. Erecting fresh barriers won't guarantee that no other company can get in, but it does make it that much harder for the next generation of would-be competitors to storm attractive markets. ▢

Reprint R0705E

To order, see page 147.



The Eco OptionsSM program: our biggest home improvement project ever.

The Home Depot® cares about the environment and preserving our natural resources. Which is why we're expanding our successful Eco Options program nationwide. Our customers will have easy access to a wide variety of Earth-friendly products. And not only can these products save homeowners money, they make it easy to curb waste, reduce pollution, save energy, and conserve natural resources. So, working together, we can all hope to make a difference. For our people. For our communities. For our planet.

homedepot.com/ecoptions



First Impressions

“There is no such thing as an infallible judge of people, at least not on this side of the Pearly Gates.”

Peter F. Drucker

“How to Make People Decisions”

Harvard Business Review

July–August 1985



“I think some people are put off by my gruff exterior.”



“You’ve got my résumé, but it’s impossible to know the real me without reading my blog.”



"Don't make me regret this hire."



"What was that 'something or other' about not being a good listener?"



"How are you at thinking outside the salary?"

CUSTOMER FOCUS

CUSTOMERS ARE THE REAL EMPLOYER – the people who fund our paychecks, the only guarantors of our jobs. Every manager and employee in every company on the planet knows that. Yet every one of us also knows how easy it is to forget customers or to get them wrong. Real customers may become figments of our collective imaginations, Joe Six-Pack Soccer Moms who exist in PowerPoint but not on earth. We may lump them together into an undifferentiated mass, selling to a lowest common denominator at the lowest possible price for the lowest possible return. We may tie ourselves up serving internal “customers” – close-at-hand colleagues whose wallets bulge with play money – while forgetting the more distant consumer who carries real cash. Or, like people who go to church out of habit but without belief, we may invoke the customer-god and go on doing exactly what we have always done: making stuff, hoping someone buys it, and when we’re wrong bringing in a new troupe of clowns to run the same old circus.

Because the customer’s power is very real, the dynamics of business drive everything toward commoditization. As surely as springtime melts snowbanks, markets erode profits.

A company can respond to melting margins in one of four ways. It can surrender, giving up differentiation and competing on efficiency and cost. It can consolidate power by buying its rivals, figuring that the biggest snowbanks survive longest. It can innovate, leaving behind the commoditized old and making money from that which is still fresh and profitable. Or it can differentiate not just its offerings but its approach to customers as

well: It can cleverly define segments of customers and sell only to those for whom it can create especially valuable offerings or work with individual customers to combine its products and services into unique packages, often described as “solutions.”

The fourth approach – which we can call customer focus or customer centrality, whichever sounds least tinny – may be the most promising in the long run because it enlists the customer on your side, helping you to define and create value together. It is also one of the most difficult management challenges there is, as you will learn from the two articles that follow. “Customer focus” isn’t just a matter of turning your head and opening your eyes, as Ranjay Gulati, a professor at the Kellogg School, points out in **“Silo Busting: How to Execute on the Promise of Customer Focus.”** You cannot get customers into your line of sight without a change in organization, incentives, planning processes, and more – in short, a change not just of mind-set but of systems and structure.

In **“Even Commodities Have Customers,”** François M. Jacques tells his story as chief marketing officer of the cement division of Lafarge, the biggest company in its industry. Lafarge had a sales staff that knew and loved its customers, but the organization lacked the smart analytics that would have helped it truly understand customers’ needs. That knowledge, it turned out, changed more than sales and marketing at Lafarge: It made people see that dealing with customers is something to which everyone can – and must – contribute. Only then was Lafarge able to treat its customers better – and, as a result, to treat itself to a remarkable turnaround.

ADVANCED MANAGEMENT
PROGRAM

BEGINS SEPTEMBER 2007

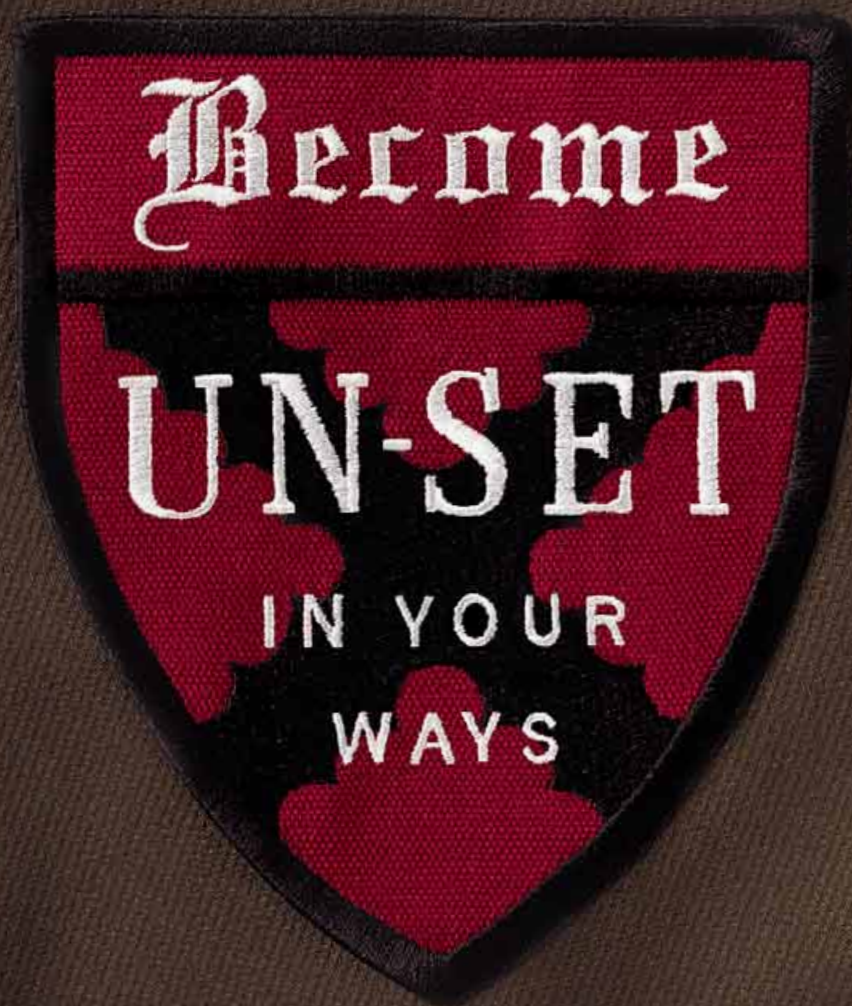
GENERAL MANAGEMENT PROGRAM

BEGINS JULY 2007

PROGRAM FOR LEADERSHIP
DEVELOPMENT

BEGINS JULY 2007

HARVARD | BUSINESS | SCHOOL
EXECUTIVE EDUCATION



Get out of your comfort zone. As a participant in the Comprehensive Leadership Programs at Harvard Business School Executive Education, you'll gain new insights from our global curriculum, our renowned faculty, and your peers. You'll also grapple with complex business issues that leaders must understand today.

Ultimately, you'll change and grow in ways that impact both your company and your career. You'll return with a whole new perspective, reenergized, and equipped to lead.

It's your time. Invest it wisely. **Learn more at www.exed.hbs.edu/pgm/clphbr/**

Companies claim to offer customer solutions, but most aren't set up to deliver them without specific changes in organizational structure, incentives, and relationships.

Silo Busting

How to Execute on the Promise of Customer Focus

by Ranjay Gulati

In 2001, under price pressure from the government and managed health care organizations, GE Medical Systems (now GE Healthcare) created a unit, Performance Solutions, to sell consulting services packaged with imaging equipment as integrated solutions. These solutions, priced at a premium, were intended to enhance productivity by, for instance, reducing patient backlogs. At the time, lots of companies were making the move from selling products to selling solutions in an attempt to differentiate themselves in increasingly commoditized markets.



GE's plan seemed to work well at first. The Performance Solutions unit enjoyed strong initial revenues, in part because most new contracts included additional consulting services valued at \$25,000 to \$50,000. And the unit had some notable successes. It helped Stanford University Medical Center, for example, make the transition to an all-digital imaging environment at its adult hospital, children's medical

on offer in the hope that customers would value the whole more than the sum of its parts.

Over the past five years, I have studied the challenge of top- and bottom-line growth in the face of commoditization, and I have found that many companies make the same mistake. They profess the importance of shifting from products to solutions – in fact, in a survey of senior executives

It's not just that the status quo doesn't reward collaborative behavior – although the right incentives are also critical. It's that the connections literally aren't in place.

center, and an outpatient facility – moves that delivered millions of dollars in new revenues for the medical center and substantial cost savings.

But by 2005, the unit's growth had begun a swift decline. It turned out that equipment salespeople had trouble explaining the value of consulting services, so when they called on customers they couldn't contribute much to the sale of additional services. What's more, these reps were reluctant to allow Performance Solutions salespeople to contact their customers. And by marketing the unit's consulting services with its product portfolio, GE generated solutions that were useful for customers whose problems could clearly be solved using GE's equipment but less compelling for those whose needs were linked only loosely to the imaging products.

In the end, GE refashioned the unit to address customers' needs in a more comprehensive fashion and to better align the sales organization. For instance, the majority of solutions now focus mainly on consulting services and are no longer marketed only with GE equipment. The solutions group secured new contracts valued at more than \$500 million in 2006. But in trying to escape the perils of commoditization, the company initially fell into a classic trap: It was seeking to solve customer problems but was viewing those problems through the lens of its own products, rather than from the customer's perspective. It was pulling together what it had

I conducted a few years ago, more than two-thirds of the respondents cited this shift as a strategic priority in the next decade. But their knowledge and expertise are housed within organizational silos, and they have trouble harnessing their resources across those internal boundaries in a way that customers truly value and are willing to pay for.

Some notable exceptions have emerged: companies that, like GE, found ways to transcend those silos in the interest of customer needs. By the late 1990s, for instance, Best Buy had nearly saturated the market with store openings and was facing increased competition not just from other retailers like Wal-Mart but from suppliers such as Dell. It tried to spark growth through various marketing approaches, but the company's efforts didn't take off until it launched a major initiative to restructure around customer solutions. Between 2000 and 2005, Best Buy's stock price grew at an annual rate of almost 30%.

Commercial real estate provider Jones Lang LaSalle (JLL), under serious price competition, made a similar strategic shift in 2001, when its large customers began demanding integrated real estate services. For instance, corporate customers wanted the same people who found or built property for them to manage it. In response, JLL adopted a solutions-oriented structure that helped attract numerous large and highly profitable new accounts.

For GE Healthcare, Best Buy, and JLL, as well as for other companies I have studied, the journey to understand and unite around customer needs was a multiyear endeavor with major challenges and setbacks along the way. The effort required systematic, ongoing change to help organizations transcend existing product-based or geographic silos and, in some cases, replace them with customer-oriented ones. In particular, I found that successful companies engaged in four sets of activities:

Ranjay Gulati (r-gulati@kellogg.northwestern.edu) is the Michael Ludwig Nemmers Distinguished Professor of Strategy and Organizations at Northwestern University's Kellogg School of Management, in Evanston, Illinois. His book *Silo Busting: Transcending Barriers to Build High-Growth, Customer-Centric Organizations* will be published by Harvard Business School Press in 2008.

Coordination. Establishing structural mechanisms and processes that allow employees to improve their focus on the customer by harmonizing information and activities across units.

Cooperation. Encouraging people in all parts of the company – through cultural means, incentives, and the allocation of power – to work together in the interest of customer needs.

Capability development. Ensuring that enough people in the organization have the skills to deliver customer-focused solutions and defining a clear career path for employees with those skills.

Connection. Developing relationships with external partners to increase the value of solutions cost effectively.

The first three sets of activities mutually reinforce the effort to put customers at the organization's fore; the fourth dramatically increases the power and reach of solutions by focusing attention beyond the firm's boundaries. All of them help companies transcend internal silos in service of higher-value customer solutions.

Coordination for Customer Focus

As GE Healthcare quickly discovered, it's easy to say that you offer solutions; salespeople may readily seize the concept as their newest product. But I've found that few companies are actually structured to deliver products and services in a synchronized way that's attractive from a customer's perspective. Individual units are historically focused on perfecting their products and processes, and give little thought to how their offerings might be even more valuable to the end user when paired with those of another unit. It's not just that the status quo doesn't reward collaborative behavior – although the right incentives are also critical. It's that the connections literally aren't in place.

One way to forge those connections is to do away with traditional silos altogether and create new ones organized by customer segments or needs. Many companies, however, are understandably reluctant to let go of the economies of scale and depth of knowledge and expertise associated with non-customer-focused silos. A company organized around geographies can customize offerings to suit local preferences, for instance, while a technology-centric firm can be quick to market with technical innovations. In many cases, functional



and geographic silos were created precisely to help companies coordinate such activities as designing innovative products or gaining geographic focus. A customer focus requires them to emphasize a different set of activities and coordinate them in a different way.

In their initial attempts to offer customer solutions, companies are likely to create structures and processes that transcend rather than obliterate silos. Such boundary-spanning efforts may be highly informal – even as simple as hoping for or encouraging serendipity and impromptu conversations that lead to unplanned cross-unit solutions. But the casual exchange of information and ideas is generally most effective among senior executives, who have a better understanding than their subordinates of corporate goals and easier access to other leaders in the organization.

One way to achieve more-formal coordination without discarding existing silos is to layer boundary-spanning roles or units over the current structure and charge them with

connecting the company's disparate activities to customer needs. JLL, which was created by the 1999 merger of LaSalle Partners and Jones Lang Wootton, had organized the corporate side of its business in the Americas into three units, each offering a particular service: representing tenants who wished to lease or purchase, maintaining buildings and properties, and managing real estate development. Each unit had authority over what services to offer, at what price, and to which clients. The units also had profit-and-loss responsibility for their respective businesses.

In 2001 the firm began to hear complaints from such large corporate clients as Bank of America that buying real estate services piecemeal from numerous companies and interacting with relatively junior salespeople were taking up too

whose needs often overlapped. In fact, in some cases each line of business offered its own technology or solution for the same problem.

However, leaders feared that organizing around technologies, which involved centralizing marketing and R&D, would distance Cisco from customers' requirements. The answer was to retain the company's three sales groups based on customer type but establish a central marketing organization – residing between the technology groups and the customer-facing sales units – responsible for, among other things, facilitating the integration of products and technologies. The marketing group also established a cross-silo solutions-engineering team to bring disparate technologies together in a lab, test them, and create blueprints for

Many product-centric companies probably start out with a focus on customers. But after early successes, they institutionalize the notion that markets respond primarily to great products and services.

much executive time. One client explained, "We like him [the ad hoc account manager], but he is too low on the totem pole." At the time, many *Fortune* 500 companies were starting to outsource all real estate management. In response, JLL created an umbrella group, Corporate Solutions, that comprised the three service units as well as an account management function, which served as a point of contact for large corporate customers. The account management group was staffed with high-ranking officers who had the authority to negotiate the pricing and delivery of real estate solutions, and the experience to help clients with strategic planning. By approaching Bank of America with a dedicated, senior-level account manager, JLL addressed the customer's complaint and was rewarded with one of just two spots (reduced from five) as a provider of outsourced services for the bank's 65 million square feet of U.S. real estate. Thus began a tremendous run that saw JLL's solutions revenue in the Americas grow more than 50% between 2002 and 2005.

Cisco Systems took a similar, layered approach to customer focus, but with a twist. The company, which had been organized by customer segment from 1997 to 2001, reverted to a technology-focused structure after the Internet bubble burst, forcing the company to address costly redundancies. Under its previous structure, Cisco had been creating the same or similar products for different customer segments,

end-user solutions. In addition to those structural measures, Cisco implemented several customer-focused processes, such as a customer champion program, which assigned senior executives as advocates for important customers. CEO John Chambers, for instance, was designated Ford's champion in 2002. In 2004 the company supplemented its advocates with cross-functional leadership teams organized by customer type, mimicking the previous structure, at least at the senior management level. Those teams – described by one executive as "the voice of the customer" – oversee six end-to-end processes that cut across functional boundaries such as quote-to-cash (the order cycle) and issue-to-resolution (technical support).

While bridging mechanisms such as cross-silo teams and processes can be very effective, they aren't easy to implement. A history of independence often leads to protectionist behavior. At JLL, for instance, business unit managers were initially reluctant to cede decision-making authority to account managers, particularly ones who lacked experience with that unit's service. Conflicts also arose over pricing and account managers' compensation. What's more, while JLL's Corporate Solutions group had positioned the firm well to meet the increasing demands of corporate real estate customers, single-transaction customers considered the relatively small number of JLL account managers in local markets to be a problem. Those customers wanted professionals

who could negotiate the best deal and execute entire transactions. As JLL discovered, the benefits of bundled solutions wear off if customers perceive a weakness in any component. Ultimately, JLL's layered approach to silo busting was still limiting the firm's growth.

To dispense with such tensions, JLL next took the more dramatic and highly formal measure of silo swapping – a wholesale, permanent structural shift to spin internal groups and processes around a customer axis. That is, it swapped its current, service-focused silos for those structured explicitly around the customer to maximize company-customer synergies. As part of that process, it replaced the account management function and the three service silos that had resided within the Corporate Solutions group with two organizations denoted simply Clients and Markets, a restructuring that put more people in the field, closer to clients, and focused all internal groups and processes on customer needs. The Markets organization handled one-off transactions, represented JLL's full range of offerings to those customers, and provided local support for larger clients. As accounts grew, they were assigned an account manager from the Clients organization, which was composed primarily of account teams managing the firm's relationships with large, multi-service customers. These teams were considered profit centers and so had the authority to hire and terminate employees. To preserve its product and service expertise without a product- and service-based structure, JLL embedded service specialists within account teams in both organizations and created a product management team charged with keeping offerings competitive. It's too soon to know how well the customer-focused silos are working, and the firm may face new, unanticipated challenges, but early results look promising: In the past year, revenues have increased by 30% and profits by almost 60%.

Culture of Cooperation

While coordination mechanisms can align tasks and information around customers' needs, they don't necessarily inspire a willingness among members of competing silos to fully cooperate and make sometimes time-consuming and costly adjustments in the interest of customers. Just as important as coordination, then, is a cooperative environment in which people are rewarded for busting through silos to deliver customer solutions. Customer-centric companies live by a set of values that put the customer front and center, and they reinforce those values through cultural elements, power structures, metrics, and incentives that reward customer-focused, solutions-oriented behavior.

Many product-centric companies probably start out with a focus on customers, aiming to design products with broad appeal. But after early successes, they internalize and institu-

tionalize the notion that markets respond primarily to great products and services. Decisions and behaviors, including those related specifically to customers, are then viewed through the lens of the product. Quality, for example, is defined by meeting internal standards rather than customer requirements. Over time, even the sales and marketing departments lose their customer focus, as product successes dominate company lore. In this way, the company develops a pervasive inside-out perspective.

In contrast, customer-focused companies, even those in technology-intensive arenas, build an outside-in perspective into all major elements of their cultures. They hold solving customer problems above all else and celebrate customer-oriented victories. At Cisco, technical innovation is clearly valued. The drive to solve customer problems fuels that innovation no matter where it leads the company, a mind-set that is reflected in the statement on all employee badges, "No Technology Religion." As one manager said, "Being able to listen carefully to create relevancy [for customers] is a more important business value than innovation." In line with this thinking, Cisco puts a relatively large number of employees in direct contact with customers, including groups such as human resources that typically don't interact with customers.

It helped that Cisco had the luxury of an existing culture of customer focus. Cofounder Sandy Lerner, in the company's earliest days, invented a customized multiprotocol router for a customer who initially found no Cisco products that met his needs. From then on, Lerner made it her mission to establish a culture where everybody, even those in units distant from customers, went beyond providing standard customer support to addressing specific problems. Consequently, even when the company reorganized its silos away from the customer in 2001, it was able to maintain enough interaction among units to ensure a customer-centric view.

At least half the battle of promoting cross-silo, customer-focused cooperation lies in the "softer" aspects of culture, including values and the way the company communicates them through images, symbols, and stories. Touting service accomplishments instead of, or at least in addition to, product accomplishments through company lore can begin to shift people's mind-sets. Cisco's employee badges broadcast a focus on customer needs, as does a well-known company legend about how Chambers was 30 minutes late to his first board meeting because he chose to take a call from an irate customer. Linguistic conventions may also be used to signify the value of the customer: Target and Disney refer to customers as "guests."

Another admittedly soft but powerful cultural tool for aligning employees around customer needs is to treat your workers the way you want them to treat customers. The hope

is that people will adopt a collaborative orientation and customer focus because they want to, not just because they'll reap a financial reward. Cisco is highly egalitarian, reinforcing the notion that all employees are important, which makes them more likely to cooperate across silos. The company offers equal access to parking spaces, for instance, and designates window-facing cubicles for nonmanagement employees, locating supervisors' offices within the interior of the floor.

Of course, the softer cooperation-promoting measures won't take hold if the harder ones—power structures, metrics, and incentives—don't reinforce them. Power structures are notoriously difficult to change. For example, in a customer-centric environment, people who are close to the customer and adept at building bridges across silos should gain power and prominence; but unit leaders responsible for products or geographies who had clout in the old organization won't hand over their customer relationships and concomitant power bases without a struggle.

That was the case at JLL. Before the company created the Corporate Solutions organization, power resided almost exclusively within the service-based business units. Even after the account manager position was instituted, final pricing authority rested with the units, which made it difficult to compete with multiservice packages. Although solutions ideally carry a premium price, JLL's initial intent was to better serve customers' needs by simplifying the management of real estate and to position the firm as a multiservice pro-

vider. However, when JLL created a package of real estate services, the price quickly mounted, resulting in sticker shock among potential customers, many of whom associated buying in bulk with discount pricing. JLL unit heads—who wanted to maximize their own return, not subsidize other units—refused to budge on prices. In some cases, package proposals were delayed, thanks to negotiations that stalled or ended in a stalemate that could be resolved only by those higher in the organization. In other cases, the packages weren't priced competitively, and the firm lost the business.

The issue of autonomy raised concerns as well. JLL's business units were accustomed to a high degree of independence. They protected their client relationships and had always been wary of introducing other services—even before the account management unit was in place—because delivery would be out of their control and they feared damaging the relationships. JLL took several steps to resolve those tensions. For one, it signaled the importance and value of the account manager role by assigning it to only very senior executives, including two who had achieved the title of international director, a distinction earned by less than 2% of employees. The firm also delivered a series of presentations at annual companywide meetings highlighting the significance of the role to the firm's growth.

To ease the pricing standoffs, JLL began in 2003 to allow account managers to provide input into the performance evaluations of business unit employees who touched their

The Four Cs of Customer-Focused Solutions

Companies looking to grow in a commoditized marketplace like to say that they offer customer solutions: strategic packages of products and services that are hard to copy and can command premium prices. But most companies aren't set up to deliver solutions that customers truly value. Successful companies make significant changes in four areas to deliver real solutions.

Coordination. In most companies, knowledge and expertise reside in distinct units—organized by product, service, or geography. To deliver customer-focused solutions, companies need mechanisms that allow customer-related information sharing, division of labor, and decision making to occur easily across company boundaries. Sometimes this involves completely obliterating established silos and replacing them with silos organized around the customer, but more often it

entails using structures and processes to transcend existing boundaries.

Cooperation. Customer-centric companies use both substance and symbolism to foster a culture of customer-focused cooperation. They develop metrics that measure, for instance, customer satisfaction and incentives that reward customer-focused behavior, even if it sacrifices unit performance. Most also shake up the power structure so that people who are closest to customers have the authority to act on their behalf.

Capability. Delivering customer-focused solutions requires at least some employees to have two kinds of generalist skills. The first is experience with more than one product or service, along with a deep knowledge of customer needs (multidomain skills), and the second is an ability to traverse internal boundaries

clients. At the same time, JLL took steps to retain some power and recognition for the business unit CEOs and, in the process, help them learn more about the services outside their silos and how they might gain personally from cross-unit sales. Unit CEOs, for example, were asked to oversee accounts on which their services were a particularly important component; in this role, unit heads were explicitly responsible for the performance of account managers. Because their bonuses were tied to the account managers' overall performance, the unit heads developed a clearer picture of the value contributed by services outside their silos. They were also required to meet regularly with customers to discuss their needs and the quality of the firm's service.

To support a shifting power landscape, firms must also embrace new metrics and incentives. The product-focused metrics most companies rely on—revenues, growth, and margins—don't reward cross-silo cooperation or customer centrality. Sales commissions in some organizations encourage managers to bring in new customers rather than nurture existing relationships, for example.

Cisco is relentless about measuring and rewarding employees on the basis of customer-related performance indicators. A Web-based survey helps determine the pre- and post-sale satisfaction of customers who buy directly from Cisco or indirectly through resellers. Survey questions focus on a customer's overall experience with and perceptions of Cisco, along with product-specific issues. Follow-up surveys

with some customers explore their experiences with certain products more deeply. All bonuses are tied directly to these customer satisfaction data, so employees are encouraged to cooperate across internal boundaries. Moreover, all employees, including interns and part-timers, are eligible for stock options.

Building Capability

Regardless of the incentives and cultural elements in place to enhance customer-focused silo busting, employees will fall back on their old competencies and ways of thinking if they haven't developed new skills. For example, even though one of the companies I studied told product salespeople to include new consulting-based offerings in their pitches to customers, the reps found it easier to give a superficial account of the new offerings or to omit them from their pitches altogether. Old habits die hard.

As a company becomes more adept at inducing coordination and cooperation across units, new skills become valued and desirable. Rather than highly specialized expertise, customer-focused solutions require employees to develop two kinds of skills: multidomain skills (the ability to work with multiple products and services, which requires a deep understanding of customers' needs) and boundary-spanning skills (the ability to forge connections across internal boundaries). Such generalist skills are typically not rewarded or developed in a product-oriented organization, so it's not easy to find customer-facing generalists. The companies that succeed invest significant time and resources in developing generalists. Furthermore, they map clear career paths for those who pursue this route.

At JLL, most of the first account managers had spent the majority of their careers in a single service unit within the firm and remained members of that unit even after becoming account managers. Consequently, they were not always deeply acquainted with the other businesses or able to manage service bundles skillfully. Account managers hired from the outside were generally chosen for their ability to execute real estate transactions, not for the breadth of their service knowledge.

To foster the development of boundary-spanning skills and cultivate a cadre of employees who could grow into the account manager role, JLL began to rotate individuals through the three remaining silos (before swapping the service silos for customer silos), forcing them to acquire greater knowledge of the products, services, and capabilities of each unit, as well as to expand their personal networks across the firm. For those already in account management roles, the company instituted training sessions through regular conference calls and meetings. Early sessions tackled relatively simple tasks, such as the establishment of a common vocabulary.

(boundary-spanning skills). In many companies, especially those organized around products, employees aren't rewarded for being generalists. Organizations that succeed in delivering solutions, however, invest significant time and resources in developing generalists. Furthermore, they establish clear career pathways for those who pursue the generalist route.

Connection. By redefining the boundaries of the company in order to connect more tightly with external partners, companies can not only cut costs by outsourcing all but core activities (and perhaps even by finding ways to outsource them) but also create higher-value solutions by combining their offerings with those of a complementary partner. Working with other companies still means crossing boundaries, but in this instance the boundaries are between a company and its partners.

Subsequent sessions focused on improving account managers' knowledge of each unit's offerings and on cross-silo sales skills and new metrics, including the first rudimentary client-based profit-and-loss statements. An unanticipated benefit of the training was that it brought the account managers together regularly, helping them to stop identifying only with their silos and to begin forming a group identity that enhanced their cross-silo networks. As a natural consequence, top management could see that account managers were assuming increased responsibility for a broader range of services.

Best Buy's shift to solutions selling entailed identifying and targeting five large, profitable customer segments: young, tech-savvy adults; busy and affluent professionals; family men; busy, suburban moms; and small-business customers. Each store was designed to suit the needs of its largest customer segment. A "busy mom" store, for instance, features personal shopping assistance and a kid-friendly layout. Stores targeting the tech-savvy offer higher-end consumer electronics and separate showrooms for high-definition home theater systems. When the company rolled out its customer-centric strategy, it conducted extensive training to help employees understand their store's particular customer segment. It also trained sales associates on basic financial metrics to highlight how their efforts on behalf of target customers affect store performance.

At the corporate level, Best Buy created a Customer Centricity University for senior officers who had not been involved with planning the new strategy. For those executives, Best Buy outlined the rationale for the new approach, including detailed financials, and held breakout sessions with the teams responsible for developing and executing the strategy for each customer segment. Over 11 months, all employees and contractors residing at headquarters, as well as many other corporate employees, participated in the program. It was then disbanded, its essential elements incorporated into the company's orientation program for new employees.

Enhancing skill sets is only part of the challenge of capability building. Companies must also develop attractive career paths that give emerging generalist stars a sense of identity and a clear route for advancement. Even specialists whose roles may not change much in the new organization will probably have to develop some generalist skills and learn how these could contribute to their advancement. JLL, for instance, at first had difficulty attracting candidates for account manager positions, largely because the firm had measured success and offered promotions on the basis of achievements within a unit. Job security was a major concern for potential account managers, as one of the first to hold the position explains: "One of the big fears was that these accounts don't last forever. So if a person left his or her specialized area of expertise to run an account and after three years...the firm was

no longer providing services for that account, employees feared that that person would be out of a job."

JLL addressed the career path issue in part through its customer-focused reorganization – whereby the Clients group housed account managers in a well-defined unit with a clear career trajectory. Other firms have developed "talent marketplaces" to signal the value they place on generalist, cross-silo skills. Modeled after informal marketplaces used within law firms, academia, and R&D units, these forums match employees on a flexible basis with available positions or assignments, thereby allowing generalist and specialist career tracks to coexist.

Connection with External Partners

The three factors we've discussed – coordination, cooperation, and capability building – are silo-busting tactics that align business units around a customer axis. But by redefining the boundaries of the company itself, firms can further fight commoditization in two ways: cutting costs by outsourcing all but core activities (and, in some cases, by finding creative ways to outsource them) and joining forces with companies that have complementary offerings to create even higher-value solutions, which command a larger price premium. Such approaches still require cross-boundary efforts, but the boundaries are between a company and its partners.

Starbucks continues to charge a premium for coffee, previously a commodity product, and exponentially increase the company's sales through intercompany relationships that keep costs low while expanding the firm's offerings. It chooses suppliers very carefully (quality and service take priority over cost) and then shares an unusual amount of financial information, using a two-way, open-book costing model that allows suppliers to see the company's margins and Starbucks to review the vendors' costs. In return, the company expects suppliers to treat it as a preferred customer in terms of pricing, profit percentage, and the resources committed to the partnership.

As for expanding its offerings, Starbucks seeks to enrich the customer experience through alliances with partners in a variety of industries. Its bottled Frappuccino beverage is manufactured, distributed, and marketed through a 50/50 joint venture with PepsiCo; its ice cream is made and distributed by Dreyer's; its supermarket coffees are marketed and distributed by Kraft, one of the company's main competitors in the at-home coffee consumption market. A more recent alliance with Jim Beam Brands brought Starbucks into a new drink category: spirits. In 2005, the two companies launched Starbucks Cream Liqueur, which is sold in liquor stores, restaurants, and bars, but not in coffeehouses.

Starbucks's boundary-expanding moves have extended to nonconsumable items as well. For several years, customers

have been able to buy CDs at the stores, and the company recently began to promote movies as part of its ongoing efforts to become, according to the *New York Times*, a “purveyor of premium-blend culture.” It sponsors discussion groups (with free coffee) and is considering selling DVDs, publishing new authors, and producing films. To coordinate these promotions and partnerships, Starbucks has formed an entertainment division with offices in Seattle and Los Angeles.

Finally, Starbucks has expanded internationally by leveraging not other companies’ products and services but the capabilities of regional partners. Whereas the company owns most of its domestic retail stores, it allows foreign companies

has expanded its boundaries by acquiring an IBM repair center in the Netherlands, allowing IBM to condense still further.

There are pitfalls to integrating closely with suppliers. Some companies—especially those that are unclear on their core values—give away too much. Others become captive to their key suppliers and lose the motivation to make ongoing investments in new technology. Some also find that they are funding the development expertise and scale that may allow a partner to become a competitor, as when cell phone supplier BenQ moved from making handsets for Motorola to marketing its own brand of handsets in foreign markets

There are pitfalls to integrating closely with suppliers. Some companies—especially those that are unclear on their core values—give away too much.

to own and operate Starbucks stores in markets where those players are already established. In 1995 Japanese specialty retailer Sazaby opened a Starbucks in Tokyo. In such cases, Starbucks provides operating expertise and control through licensing, while the foreign partners take on financial risk and advise Starbucks on real estate, regulations, suppliers, labor, and culture in the markets they know best. Sharing responsibilities in this way requires Starbucks to apply the principles of coordination, cooperation, and capability building to its external relationships.

Starbucks’s relationship-building capability has enabled the company to grow far faster than it could have on its own. What’s more, with just about every fast-food company selling premium coffee, and versatile and affordable new coffee-makers lining the shelves at Target, the company has been able to shore up its position by selling not just coffee but a coffeehouse experience, built largely around a series of partnerships and alliances that provide customers with an array of high-quality offerings.

Such relationships can be mutually reinforcing: As one company shrinks operations to cut costs—seeking partners to take on formerly in-house activities—its suppliers must expand their horizons by increasing the range of their offerings or finding their own partners to help them do this. IBM, even while taking over major back-office operations for large companies, has condensed its own core operations by outsourcing activities like repair and server manufacturing to contractors such as Solectron. Solectron, in turn,

where Motorola already had a presence. Integrated partnerships can also be risky if companies put a lot of information into their vendors’ hands, as Starbucks does. If trust on either side is eroded, one party could misuse the information.

In managing external relationships to avoid such pitfalls, it makes sense to apply the principles used to manage across internal silos—particularly the principles of coordination and cooperation. The challenges of internal and external execution are not exactly the same, but they share many themes, such as the need to find efficient ways of exchanging information and aligning incentives. So, for instance, Starbucks has a set of formal coordination structures to help information flow between partners. In addition to regular meetings between senior management on both sides, Starbucks has a dedicated training program for employees who will be involved in managing supplier relationships. To ensure that both parties follow clear rules for knowledge sharing, the company has created a handbook for suppliers, which describes the firm’s purchasing philosophies and policies, along with the standards vendors must meet on eight criteria.

Cooperation issues may be even more central to external relationships than to internal ones, given the need to apportion value fairly among parties and the omnipresent risk of opportunistic behavior. Cultural fit lays the groundwork for cooperation, and efforts at cultural synchrony may begin even before the partnership does. Starbucks not only conducts a careful assessment of a supplier’s brand and

operations but also evaluates cultural fit, largely through an event called Discovery Day, when prospective partners come to Seattle to discuss cultural and other commonalities as well as differences between themselves and Starbucks.

In today's ever expanding and shifting business arena, and in light of a growing focus on customer needs, the definitions of what is inside a company and what is outside are no longer clear. But as our sense of firm boundaries evolves, so will our understanding of how best to breach internal and external barriers.

...

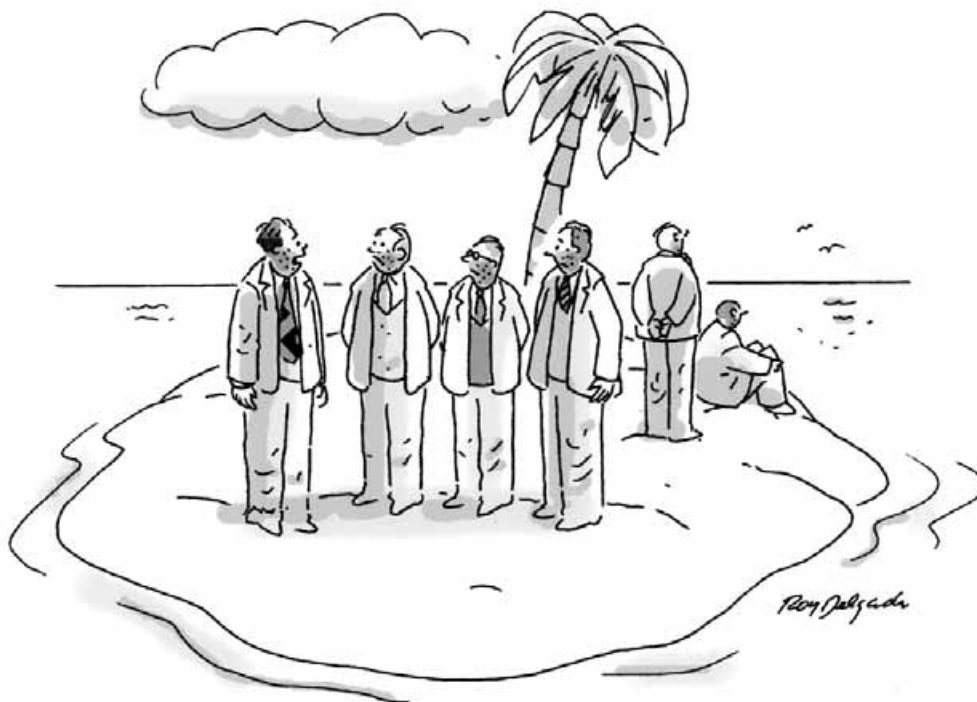
There are few downsides to developing true solutions. The risk is that in the rush to stand out in the crowd, many companies forget that solving customer problems requires a deep knowledge of who their target customers are and what they need. Some customers are better off purchasing products and services piecemeal. Leaders at GE Healthcare originally targeted solutions at large national accounts – which, it turned out, bought largely on price. These clients almost by definition weren't good candidates for the solutions offer-

ing. The company consequently refined its target customer profile to focus on multihospital systems – with at least \$500 million in annual revenue – that demonstrated a willingness to provide GE with meaningful access to the most-senior executives. Through this targeting, GE Healthcare narrowed its focus to just 150 of the roughly 400 multihospital systems in the U.S. health care market—giving primary attention to 50 accounts that included customers ready to enter into a contractual relationship with GE and those that exhibited many key characteristics and expressed a willingness to work with GE.

The lesson for GE, as for others, is that it doesn't pay to put the solutions cart before the horse of coordinated customer focus. To stand out in a commoditized market, companies must understand what customers truly value. The only way to do that is to break down the traditional, often entrenched, silos and unite resources to focus directly on customer needs. ▢

Reprint R0705F

To order, see page 147.



"I'm beginning to wonder if our company really sent us off to a company retreat."

The best way to innovation has never been so clear.

During the next six years, as 70% of today's products grow obsolete, leading innovators will be racing to get to market faster, optimize resources and achieve globalization. They'll rely on UGS Product Lifecycle Management (PLM) solutions to guide them to greater innovation and accelerated growth. Do you see the signs of innovation in your company? Let UGS point you down the right path.



Where are you on the way to innovation?
Find out with the UGS Innovation Assessment.
www.ugs.com/assessment



There are a lot of tired businesses trapped in a commodity, “sell at all costs” mind-set. The success story at Lafarge shows how much they can benefit from consistently applying the basic tools of marketing.

Even Commodities Have Customers

by François M. Jacques

When I became head of marketing at Lafarge’s cement division in late 2001, old-timers used to tell me that there were only two types of customers: those who liked golf and those who liked fishing. Welcome to the front lines of your typical cement company – a hardscrabble world peopled by grizzled salesmen whose pitches were aimed at making friends rather than demonstrating that their products were better than the competition’s.

And why shouldn’t they? After two decades of worldwide deregulation, cement was becoming a commodity. There was virtually no cement product you couldn’t easily obtain from some other company. Global production was fragmented. Lafarge, as the world’s largest producer, accounted for only 6% of the market, and our customers tended to be large, sometimes global, businesses whose purchasing decisions were becoming increasingly centralized. In this environment, marketing took a backseat to sales. The name of the game was not differentiation and value propositions but protecting market share without triggering a price war that no one could afford.



Still, as Lindsay Owen-Jones once observed, “There is no such thing as a product that cannot be improved by segmentation.” The story of Lafarge cement division’s marketing initiative, which I had the privilege of leading, exemplifies that sentiment from L’Oréal’s CEO, a former Lafarge board member. Our work directly added \$6 million to the bottom line in our first year of operation, and today our contribution stands at an accumulated \$150 million. That’s the equivalent of a 2% price hike.

It isn’t easy to establish a marketing function in a company that doesn’t think it needs one. From the start, in 2002, we tackled the challenge on a number of fronts. First, I sought to gain allies and neutralize potential foes in the executive ranks by carefully populating an executive steering committee, which set right to work applying marketing’s most basic and most powerful tools – segmentation and pricing strategy – to four representative pilot projects. To make the value of those efforts quickly apparent, we measured the effectiveness of those pilots with readily understood metrics. We sought to share our ongoing results as widely as possible by establishing regional networks of marketing and sales executives. We began to weave marketing into Lafarge’s mainstream management processes by becoming an integral part of the division’s and the units’ strategic-planning, performance, and budgeting discussions. Over the next four years, we built on that wide base through a number of techniques aimed

of customer requirements, increasing value both for our customers and for us. We’ve developed a CRM tool that tells us each customer’s value to Lafarge. That means we no longer need think of cement as a commodity—we can protect prices without compromising sales volumes.

Like Lafarge in 2001, many companies have a marketing function in name only. For them, as for us, the transformation needed to reap the rewards of genuine marketing savvy will involve a profound cultural and organizational change. That’s never easy. This article recounts the seven main lessons we learned as we turned our manufacturing-driven, commodity-minded business into a profitable, marketing-oriented enterprise. I believe these lessons can serve as a model for other companies looking to escape the commodity trap.

RULE 1 Make Lots of Friends

Many new initiatives are imposed from the top and dismissed by the bottom as a passing fad. In these situations, you have to make sure both that top management stays committed and that everyone on the front line knows top management will remain committed.

Lafarge’s marketing initiative was just such a top-down project. Corporate management had directed the entire company to boost its marketing capabilities back in 1999.

I was attracted by the challenge of creating a marketing function from scratch. But most of the people I knew were incredulous.

at strengthening the advances we made in the first year. (See the exhibit “Introducing Marketing to Lafarge: The Time Line.”)

Step by step, we fundamentally transformed Lafarge’s commodity mind-set. Segmenting customers allowed us to see that we were selling to different groups that required different products, which in many cases we could sell for higher-than-commodity prices. Customer satisfaction surveys led us to change the way we sell: Now we talk about customers’ needs rather than the fish that got away. That led us to improve supply chain execution and ultimately to change what we sell, so that our offerings are now suited to a range

A corporate head of marketing was appointed that year, and marketing chiefs were quickly put in place at three of the four divisions – gypsum, roofing, and aggregates and concrete.

But Lafarge struggled to find someone to take charge of marketing for the cement division. That was hardly surprising, given the job description. The senior executives in the cement division, making the mistake of confusing salesmanship with marketing savvy, believed that they already had adequate marketing expertise in the division’s business units. All that was required, they reckoned, was an effort to share knowledge and coordinate the marketing efforts of

A former consultant at McKinsey & Company in New York, **François M. Jacques** (fmj.jacques@gmail.com) is currently the senior vice president responsible for marketing at the cement division of Lafarge, a global building-materials company based in Paris.

the units' current sales managers. As a result, the executives envisioned the division's marketing head as merely an *animateur*—a facilitator—who would operate without a support team, or even a budget. You can imagine what kind of signal about top management's engagement that sent to potential applicants, not to mention the heads of the operating units.

My consulting background at McKinsey & Company made me more comfortable than most Lafarge executives were with this role, and I was attracted by the challenge of creating a marketing function from scratch. But most of the people I knew were incredulous. The division's retired head of manufacturing even took the trouble to come and tell me about his experience 15 years before, when Lafarge had previously experimented with the position. He had found the job very lonely. He was always blamed for failures and never credited with success. The general managers of the business units always scooped the prizes.

Despite all this negative feedback, I felt there would be support within the division for investment in marketing capabilities if I could demonstrate to people on the front lines that top management was really serious. I decided to begin by getting one or two divisional executives to assume some formal sponsorship role for the program. I was looking for a couple of top executives to share responsibility for the program's success or failure and to form, with myself, the core of a top-level steering committee that would meet monthly to review progress.

I began by sounding out members of the cement division's executive committee. I visited each of the nine regional heads who served on the committee and gave a presentation listing the challenges the division faced. I proposed a five-year road map for the marketing effort that defined its objectives in terms of tasks, staffing, and measures of success. The purpose was not so much to sell the road map as to see who would buy in to the kind of things we would need to do if we were to escape a commodity mind-set.

Predictably, most were cautious. They accepted my ideas but said that there was no need to rush. Two people, however, took strong positions. One told me that my plan was far too ambitious to have any hope of succeeding. The other was supportive. Looking at the profiles of each man, I realized that I had found both of my sponsors. The strongly positive executive really understood marketing, having had experience in another industry. The strongly negative regional head, however, was also a potential sponsor. His extreme response indicated that he was engaged with the idea, and through conversations about him with colleagues, I learned that much of his apparent hostility stemmed from past bad experiences with marketing in another division of Lafarge. Leaving him out would guarantee an enemy. Bringing him in might make a convert.

Having engaged top management, I turned to the people who would make or break the project: the general managers of the cement division's 45 business units. I started bombarding them with short (two-page) memos explaining how marketing related to every aspect of their businesses, a practice I continue to this day. At times, I would get the division's CFO or CIO to cosign these memos. This had three benefits. It reassured divisional officers that I was actively on the job. It tied my name, in the eyes of the general managers, to those of two senior executives. And it encouraged the GMs to actually read the memos, which in turn helped educate them about marketing.

The success of the initiative required more than getting the general managers to take me seriously, though. They had to own the initiatives themselves, so as I proceeded I was careful to stay in the background when the actual work being done to further the initiative was presented. *They* had to shine, not me or my marketing colleagues. By late 2005, when Lafarge held the convention of its top 900 cement executives that it convened every five years, marketing took up a third of the agenda, but almost none of the presenters were marketers.

RULE 2 Begin with the Basics

Executives in companies that put sales before marketing need a lot of education. They may think they know about marketing because they have good salespeople, but the reality is that they know very little. One consequence is that they bandy about marketing concepts and terms very loosely. Lafarge was no exception. Some business units, for example, used the phrase "customer segment" to refer to all customers served through a given distribution channel, while others used it to mean a group of customers of similar size or related ownership.

In these situations, you have to start by making sure people understand and agree on the basics. Fortunately in an industrial culture like ours, people do respect careful analysis, and so we began with a classic segmentation analysis, the most basic marketing concept of all.

With the help of a consultant, we reviewed customer data drawn from four selected business units that served as pilots for the initiative. This analysis revealed that the customers of those four units could be segmented according to their purchasing behavior (price driven, relationship driven, or performance driven) and according to the sophistication of their businesses (for example, those with quality control labs to make sure their bridges were safe versus small firms doing house additions). As we rolled out the initiative, we found that we could maintain a common segmentation scheme for all of our units, though obviously we refined and changed the segment definitions as we went along.

Developing a common understanding of what constituted a customer segment made it eventually possible for us to establish common standards for other marketing concepts and tools. Today, we have a largely consistent process for determining prices, which enables us to police them far more effectively and to implement value-based pricing—that is, pricing based on what a product is worth to a customer rather than on what it costs to produce. We have also created a common sales force philosophy that focuses on channels rather than on geography, as well as a common range of products and brands.

The pilot projects have contributed greatly to our tool kit, as well. One computer-savvy UK manager automated some of the analyses we had done painstakingly by hand in the other pilots. Based on his work, we developed a prototype CRM tool that's now been rolled out to all the other units.

Once the new definitions and tools became broadly accepted, we began standardizing the way unit managers approached the marketing-planning process. Previously, any unit that had even attempted to put together a marketing plan had had to reinvent the wheel. No two marketing plans were the same. One unit might have prepared 150-odd PowerPoint slides; another would come up with a one-page outline. Each unit would set its own milestones and metrics. This variety made it difficult for corporate or divisional executives to evaluate the plans or compare one unit's performance in execution with another.

So I decided to create a marketing plan template for all the units. We first looked at plans developed in the other Lafarge divisions and found them either too shallow or too detailed. In the second quarter of 2003, I decided that the division should develop its own format, and I drew up a straw man template. By that time, we had instituted six annual regional sales and marketing conferences, which afforded the perfect opportunity to present the template to the sales and marketing managers of all the units. Half a day at each conference was devoted to discussing and refining the plan, which was concurrently beta tested in the four pilot business units. Since the end of summer 2003, all 45 business units have been posting three-year marketing plans in a common format on the company intranet. I use the same format for the divisionwide global marketing plan, which I started distributing to general managers in 2005.

RULE 3 Win Early, Win Often

Any important culture-changing initiative needs to prove its value early on. That's particularly true when you're trying to convince managers in a very manufacturing-oriented company about the value of a function they have largely been taught to despise. In our case, this meant showing that our new segmentation could quickly deliver tangible results in a few representative business units.

The obvious place to look for evidence of success was in the way we set and negotiated prices: In a commodity business like cement, a 1% gain in price has twice the impact on NPV of a 1% increase in volume or a 1% reduction in cost and four times the impact of a 1% savings in investment.

We had to show that our new approach would be valid for all units everywhere. At the same time, we wanted to attract as much attention and support as possible in the cement division's executive committee for the marketing effort. That's why we put so much care into the selection of the four pilot units. Chosen to be representative of the division as a whole, they together accounted for a significant 16% of its revenues. We were also going for a geographic mix that would give four members of the executive committee a personal connection with the work. The units we selected were: Northeastern North America (which sold bulk cement for the ready-mix concrete channel in a mature market); the Philippines (which sold bags of cement mainly through the wholesale-to-retail channel to an emerging market); Romania (which sold both in bulk and bags, but also had a large contractor channel, in an emerging, former Soviet market); and the United Kingdom (which sold both bags and in bulk, and had a large presence in the precast-concrete-products channel, in a mature market).

The segmentation analysis quickly confirmed our suspicions: Customers belonging to the same segment in the same geographic area were paying different prices for the same products bought in the same quantities. The first implication of that finding was obvious—we had been giving away far too generous discounts to some customers. Clearly, this meant that other customers were not being dealt with fairly. It also meant that we were leaving a lot of money on the table. Faced with this evidence, the local marketing and sales teams decided to eliminate discrepancies (discounts, rebates, and so on) between quoted and pocketed prices by setting minimum threshold prices in each segment and by formalizing the rules for negotiating prices and discounts with each customer.

The results were impressive. In Romania, more consistent pricing generated an overall rise in profit margins of 0.6% in the very first year (2002). More consistent discount negotiation in the Philippines also produced an immediate margin improvement of 0.4%. Setting a minimum price threshold for each segment in the UK generated a whopping 1% improvement in profit margins over two years. At the same time, the move ensured that similar customers were treated in the same way.

Not only had we been failing to address similar customers in the same way, we had been losing opportunities to treat different customers differently. Segmentation allowed us to identify which customer groups, geographic locations, and distribution channels had the most profit potential, enabling us to be more proactive in setting prices. This was true even

Introducing Marketing to Lafarge: The Time Line

	2002	2003	2004	2005	2006
Make friends	- Found sponsors among division executives. - Formed steering committee.	Began sending update memos to unit general managers.			
Begin with basics	- Conducted first customer segmentation. - Began to differentiate pricing.	- Standardized marketing plan template. - Developed basic CRM system.	- Introduced sales force specialization by channel. - Started rationalizing product range in response to end-user surveys.	- Began to standardize brands from unit to unit. - Introduced value propositions.	Initiated value-based pricing.
Win early and often	Selected four units for initial pilot project.	- Added five more units to pilot project. 0.1% gain in profit margin.	- Added last six units to pilot project. 0.3% gain in profit margin.	0.9% gain in profit margin.	1% gain in profit margin.
Measure	Tracked pricing practices with scatter plots and waterfall charts.	Began tracking margins.	Worked out how to isolate the financial impact of targeting different combinations of geographies, segments, and channels.	- Initiated customer satisfaction surveys. - Began to measure how often deliveries were made on time, in full, and invoiced correctly. - Started tracking revenues from new products.	Began comparing our price premium against competitors'.
Share	- Formed six regional Sequoia marketing and sales networks. - Held first marketing seminar.	Instituted the six regional conferences.	Began pairing up business unit marketing and sales managers.	Started distributing divisional marketing plan to GMs.	
Stake out territory	Brought in consulting support.	- Created temporary marketing task force at divisional level. - Began establishing marketing function separate from sales at the unit level.		- Central marketing team made permanent. - Reached the point where more than 20% of high potentials are in marketing.	
Find your place	Began attending pilot units' strategy review meetings.	Started incorporating marketing resource and revenue projections into divisional performance plans and budgets.	Developed marketing and sales competency profiles.		Implemented training modules for the sales and marketing staff.

for a mature and supposedly well-understood market like the UK, where we estimated the potential margin improvement could be as much as 2.4%.

By the end of 2003, the original four pilot marketing initiatives had improved the division's overall margins by 0.1% of global sales, sending an additional \$6.4 million to the bottom line, and another five units had signed on to the project. Today, most business units are engaged in the marketing initiative, and we estimate that our accumulated contribution will rise to \$260 million by the end of 2008, the equivalent of a 3.5% price hike.

RULE 4 Measure, Measure, Measure

When executives at Lafarge inspect a plant, they judge what they see according to a whole slew of metrics. Unless we could provide equivalent metrics for marketing, I knew senior executives would not connect our marketing efforts with the financial results they were actually generating. We had to have some measures right from the start, even if they were not perfect; we could always refine them later. We found that we could easily and effectively co-opt two tools

Following that pilot, we rolled out a standardized customer satisfaction survey to other units. The benefits of this exercise are threefold. First, the survey highlights the areas that require urgent action at the unit level. Second, it helps the central marketing team spot patterns that call for global responses (such as being more aggressive in customer training and support in emerging economies). Last, it lets us calculate an index that can be compared from year to year, thus yielding a quantitative measure of progress.

Results from our Romanian survey led us to develop our next measure, OTIFIC. Adapted from a metric already used in other Lafarge divisions, it tells us how often we make deliveries "on time," "in full," and "invoiced correctly." We piloted the measure in 2005 in our South African business unit and have just rolled it out to the other units. It's a global index that can be broken down to reveal the most frequent and most important sources of execution dysfunction along our value chain. Over time, we think it will help us link customer perceptions of our performance to our own perceptions.

More recently, because our product range has been substantially changed as a result of our understanding of end-user

One executive told me that my plan was too ambitious to have any hope of succeeding. The other was supportive. I realized that I had found both of my sponsors.

that division executives were already using—scatter plots and waterfall charts—to measure the results of the pilot pricing improvements. Demonstrating our margin gains in that familiar way was what enabled us to attribute the financial successes that followed our pricing exercises directly to our marketing efforts. As we continued, however, we knew that we would have to develop more powerful metrics to link what we were doing more precisely to the financial results.

Companies that put sales first tend to equate customer satisfaction with sales volume. But, clearly, once you start treating customers differently, it makes sense to measure the effect of your efforts directly. When we did, we found opportunities to differentiate our business that we had never considered. In 2005, for example, when we sent out our first survey to customers in Romania to see how they felt about our changes, we found that they would be happy with our harder line on prices as long as we improved the ordering and delivery processes.

usage, and since we've begun to roll out such innovations as dust-free cement and waterproof packaging in response to customer interest, we have decided to track the percentage of annual revenue coming from three-year-old products at the unit and division levels.

Other metrics we're developing will also link our marketing activities to the top line. One will measure the price premium we enjoy relative to our competitors because of our segment-tailored value propositions and superior execution. Comparing our average prices at year's end to certain competitors in each country is our current first proxy. By this crude measure, Lafarge is lagging its competitors (by \$7 per tonne compared with Holcim and \$2 per tonne versus Cemex). We believe, however, that their higher prices reflect the different geographic mix of the markets they operate in, and we suspect that the difference would be a lot greater if we had not undertaken our marketing initiatives. Our aim, therefore, is to try to break that difference down into a



geographic and a marketing component, so that we can quantify how our marketing efforts are helping the division close the built-in price gap against competitors.

RULE 5 Share, Share, Share

It's always important for managers to share their new ideas, good news, and experience. When you're trying to create a new skill base, however, the important becomes essential. In an organization without a marketing culture, we absolutely had to shout out about what we could bring to the party, to get everyone talking about it and make sure that as many people as possible were trying the ideas out.

Our first foray into spreading the word was at a marketing seminar we first held in fall 2002. We brought together managers from eight business units in Paris to hear what the four pilot units were doing and discovering. This was the division's first structured exchange of marketing ideas, and it allowed us to communicate best practices related to both core marketing activities (like our segment and pricing strategy) and support activities (such as the sales-planning process and sales force management tools). The next year, we brought the four units together again to share their continuing experiences, including roadblocks, insights, and lessons learned.

Today, our principal peer-to-peer forums are six regional networks, made up of each unit's senior marketing and sales managers, which hold the six regional conferences each

year. A highlight of these two-and-a-half-day meetings is a visit to a problem customer, organized by the local unit. Meeting participants tour the site and interview the customer to understand his or her concerns. Then they go back and together come up with a way to address those concerns. The host unit implements the group's solution, and the next year a joint follow-up is done. Not only is this a great way to learn, but customers like the attention.

From the beginning, some networks worked better than others. Not all regions share a natural sense of identity, and some of the more mature units felt they were above the pack. To foster improvement in the networks, the divisional marketing team runs quantitative and qualitative feedback surveys, which guide constant improvements in the annual conferences. These are formalized in a "network-meeting best practice" document, which the central team updates after each annual session.

To continue to promote direct knowledge transfer between the business units, we started in 2004 to pair marketing and sales executives at units that are further along in their marketing expertise with their counterparts at units that are similar in other respects. Chile mentored Honduras, for instance, working on customer satisfaction surveys, market segmentation, new product launches, and software for tracking customer complaints. Concurrently, we've been promoting relationships between marketing "equals." Poland and Romania, for instance, conduct joint reviews of their marketing plans. Most exchanges involve one face-to-face

meeting, which often includes a plant or customer visit, preceded and followed by mail and phone contacts.

The program encourages managers to think harder; you don't want to look stupid to your colleague in a different unit. And because you have to explain yourself, you put effort into formalizing what you have to say. The program is also efficient: a time commitment of 30 face-to-face exchanges involving two representatives per unit over two-and-a-half days each year. That's the equivalent of a full-time employee at the division level but far more effective in spreading insights throughout the units than any single person might be. At this writing, 25 of the 30 original pairings are still going strong.

As our appetite for marketing knowledge grew, we began creating a Web site to organize and distribute all the processes and tools we were developing. In setting up the service, however, we felt we had to resist being co-opted by the central manufacturing function, which had more than a decade of experience in knowledge management. Indeed, when our project started, four "marketing" best practices were already listed on manufacturing's intranet site. We managed to preserve our independence on a trial basis, and then permanently, by adopting on our site the standard look and feel that was later codeveloped by all functional departments. That had the effect of elevating marketing to a coequal status among the functions.

Another important issue was determining who could use the site. We had requests for access from many sales and marketing representatives worldwide, including trainees. But the site contains a lot of confidential data that cannot be shared with anyone other than the business units' executive committees. We therefore adopted a very crude rule that only those people allowed to attend the network meetings would have access to our site. We call both our knowledge base and executive network "Sequoia." As befits a marketing function, we're the only one with its own brand.

RULE 6 Stake Out Your Territory

As word of our successes spread in late 2003 and early 2004, general managers of units that had not been picked for pilot projects started grumbling that they were being ignored by central marketing, and that as a result their bottom lines were suffering! Until that point, I had gotten around our resource constraints by having the business units hire external marketing consultants to help them, but that was not a long-term solution. Building some sort of central-marketing operation was essential if the company's initiative was to succeed. Unfortunately, initial resistance to the idea of a central function was strong. The nine regional heads all wanted to have their own marketing staffs, just as they already had their own industrial staffs. The division executives, meanwhile, were worried about overhead.

To get around this problem, I asked for approval for a temporary task force made up of three executives who would report to me and focus strictly on introducing marketing tools in only certain business units—specifically, 15 units that made up two-thirds of the division's revenues. The beauty of the temporary task force concept was that it could be extended and renewed into de facto permanence. It remained nominally a temporary task force until 2005, when Lafarge formalized the divisional marketing function, which by then had expanded to six executives, all recruited internally.

A key factor in that concession was the recognition I had won that marketing and sales were two different functions operating over different time horizons and requiring people with different skill sets. Right at the start, I had advocated relieving the sales VPs at the pilot units of marketing responsibilities. Of course, there was resistance. Some units, for example, claimed they were too small to justify the split. One agreed to separate marketing from sales but proposed merging it instead with strategy. To win the units over, I reprised the concept of a temporary arrangement. I proposed that the 15 priority units should accept the split for the two to three years we would be trying out the segmentation and pricing changes and suggested that we could revisit the arrangement again later. As before, this was a good face-saver. Today, the idea of an independent marketing function no longer seems strange; wherever we have split the two, our marketing performance has shot ahead.

As we staked out our organizational territory, we looked for the right people to settle the land. We supported the recruitment drive in the units by providing marketing job descriptions, suggesting candidates from other divisions, and participating in the final-round interviews. I felt strongly about getting involved in this drive because I wanted the new executives to be general-manager material, as this would reinforce the cultural change we were after. By 2005, HR found that about 20% of the division's high potentials were in marketing.

RULE 7 Find Your Place

There's a tension inherent in creating a new function. To obtain recognition, you have to fight to establish independence. But then, to retain independence, you have to fit into the organization's workings as a whole. Otherwise, the new function risks being sidelined, weakened, and ultimately subsumed back into other functions. To avoid that fate, we knew, divisional marketing executives needed to become an integral part of the company's management routines. This was a struggle at first. Most of the major strategy and budget-planning meetings were dominated by operating managers—regional heads and general managers—who were suspicious of the new faces from divisional headquarters. I was

actually asked to leave one important meeting of GMs because the regional head who was in the chair had not been notified by my boss that I would be participating. We've come a long way since then.

Strategic and performance planning. From the start, I insisted on joining the pilot business units' annual strategy review meetings. Market forecasts for these meetings had hitherto been drawn up with an economic lens—where were we in the cycle, and so on. I was there to get people to think about how customer behavior might affect the numbers. I followed up on these meetings by sending detailed memos to the unit heads pointing out just where the strategic plan touched on, or depended on, marketing. By 2005, marketing was the most recurring priority in the three-year rolling performance plan after safety, a fact that we have been careful to publicize internally.

the anticipated extra sales arising from the promotion effort have been incorporated into the numbers.

Executive visits. Visits from regional heads are an important part of the Lafarge management routine, and we make sure that they always talk marketing when they visit a unit. At first, I personally supplied every divisional executive going to a unit with a copy of that unit's marketing plan to read on the plane. Over time, executives have gotten used to talking about marketing on their visits, and now it's standard practice for them not only to take the plan but also to visit at least one customer (if possible, one with problems) before visiting our plant and talking to unit managers.

Career development. Finally, with so many high-potential managers in marketing functions, we realized that we had to put marketing at the heart of Lafarge's career-planning and development efforts. That meant reaching out to people

The beauty of the temporary task force concept was that it could be extended and renewed into de facto permanence.

The format of the standard marketing plan was also designed expressly to help marketing feed into the strategy process. The final section lays out not only the financial results expected from marketing initiatives but also what resources we need from the division and other functions to achieve those goals. These requests are fed into the business units' performance plans, which means that the units' executive committees assume responsibility for ensuring that marketing goals are supported.

Budgeting. Thanks to our involvement in the planning process, unit budgets began in 2003 to incorporate projections of the revenue marketing would generate. Even so, many Lafarge executives had a tendency to see marketing as a cost input (and potential saving, if cut) but not as a revenue input. Since 2003, my team and I have made sure that the nine regional heads on the executive committee recognize that divisional revenue estimates are affected by our activities; if they want to cut a marketing expense, they now realize that the cut will almost certainly affect future revenues.

We now send each regional head a one-page, bullet point outline of what to look for in the units' performance plans in terms of pricing strategy; market share projections; and the marketing, sales, IT, and technical service resources needed to realize those projections. If a unit is contemplating a new product launch, for instance, we take care that the committee is aware that both the promotion costs and

in HR and training. In 2004, my team finalized with HR and my marketing counterparts at the other Lafarge divisions a marketing competency profile and assessment tool, which we piloted in Greece. We are using the assessment to shape individual career development plans for all marketing personnel. The plans are supported by training modules, which have been tested in South Africa and are currently being rolled out, starting with the 15 priority units. Throughout the process, we've been careful to leverage HR's existing techniques, formats, and tools, in a joint shared effort with the HR and training department.

...

When I started this project, I sometimes resented the fact that we had to fight and contrive to get what we wanted. Why wouldn't the company put its checkbook behind its rhetoric? A manufacturing initiative would not have been so shortchanged. Looking back, I now suspect that the privation may actually have helped us because it forced us to work that much harder. Although this is still a work in progress, Lafarge can now count marketing as one of its core competencies, and if my team and I were to be shown the door tomorrow, the practices and processes we have introduced would continue to thrive. □

Reprint R0705G

To order, see page 147.



THERE IS NO EASY OIL. MUCH OF IT IS SCATTERED IN HUNDREDS OF ISOLATED POCKETS. AND BUILDING LOTS OF OIL RIGS IS JUST NOT AN OPTION, ENVIRONMENTALLY OR ECONOMICALLY. THEN SHELL ENGINEER JAAP VAN BALLEGOOIJEN WATCHED HIS SON DRINK A MILKSHAKE. SUCKING THE BITS OF FROTH FROM THE CORNERS OF THE GLASS WITH HIS BENDY STRAW. HEY PRESTO, THE SNAKE WELL DRILL WAS BORN. A DRILL THAT CAN BEND ROUND CORNERS AND SNAKE FROM SIDE TO SIDE TO REACH THOSE SCATTERED POCKETS OF OIL, ALL FROM ONE RIG. REAL ENERGY SOLUTIONS FOR THE REAL WORLD. WWW.SHELL.COM/REALENERGY





Picking Winners

How the “genius grants” are awarded

A Conversation with MacArthur Fellows Program Director **Daniel J. Socolow**

THERE ARE A NUMBER OF FELLOWSHIP PROGRAMS whose goal is to recognize extraordinarily gifted and creative people. Very few have etched themselves on the American imagination as powerfully as the MacArthur Fellows Program. Like the Pulitzer Prize or the Rhodes scholarship, the MacArthur is widely seen as one of *the* awards to win—remarkably, given that the fellowship, one of the first major programs of the John D. and Catherine T. MacArthur Foundation, is only in its 27th year.

The MacArthur is, to be sure, a generous prize: Recipients get half a million dollars with no strings attached. It's not the money that gives the award its cachet, however; rather, it's the validation—the recognition that the winner is an exceptionally creative person in his or her field, deserving of a “genius grant,” as the fellowship is popularly called. That can inspire a great deal of self-congratulation, and not a little envy on the part of colleagues and

competitors who missed out. Although nobody can apply for a MacArthur, many can aspire to one. Recipients must reside in the United States or be American citizens; otherwise there are almost no restrictions on who can win (the IRS has ruled out senior-level government officeholders and employees). A record of achievement counts, but fellows need not be publicly acclaimed writers or scientists or mathematicians.

The success of the program suggests that it has worked out a pretty reliable way of picking winners. Although the MacArthur selectors have anointed many obscure people over the years, in relatively few cases have critics called the award unmerited. What's more, unlike the Nobel Prize, to which it is sometimes compared, the MacArthur is more than an award for past achievement; winners are expected to use it to take their abilities to a new level, and in many cases they have done just that.

In the business world, "creativity" has become the latest buzzword. Corpora-

tions, no less than the MacArthur Fellows Program, are interested in identifying and attracting unusually creative talent—the kind that will come up with the next Lipitor, Walkman, or iPod. How to find, nurture, and direct these people is an enduring topic in business

I'm not saying that we will never give a MacArthur fellowship to someone in business. They're not officially exempt.

literature, particularly since commentators started talking about the knowledge economy and human capital. To find out more about the lessons the MacArthur program can offer to businesses, HBR senior editor Diane Coutu approached the program's director, Daniel J. Socolow, for a contribution to the magazine.

Socolow, who has run the program since 1997, brings to the job the same richness of experience that characterizes many of the fellows. In the 1960s he lived in Argentina and worked for the Ford Foundation on its grant programs for Argentine universities, which were struggling to reestablish themselves after a series of political and economic crises. In the early 1970s he set up one of the first programs in Canadian studies at a U.S. university. In the late 1970s he was appointed a vice president of Spelman College, a black women's college since 1881. Socolow has also served as president of the American University of Paris and as a senior adviser and the director of programs at the Carter Center, in Atlanta. Before joining the MacArthur Foundation, he helped start a number of companies, most notably Third Age Media, an early interactive site for linking older Americans and the Internet. In the following edited conversation, which took place at the MacArthur Foundation offices in Chicago, Socolow

explains the stages of the selection process and what factors the selectors take into consideration when choosing fellows. He discusses the award's impact on winners and suggests what business leaders might learn from the program.

Does someone have to be a genius to win a MacArthur?

The concept of genius is far too limiting when describing MacArthur fellows. Genius is a measurement of intelligence—it's an immensely high IQ. The people we're looking for have razor-sharp intelligence, but they add to that a lot of other qualities, such as boldness, commitment, resilience, and persistence. We're looking for people who are trying to come up with something new, who play at putting things together in novel ways. There's no easy definition for that. That's why we use somewhat messy terms like "exceptional creativity," "outstanding talent," "extraordinary originality," "insight," and "potential." We're intentionally ambiguous, because once we try to define what we're looking for, we lose the power to consider many different kinds of people. For us, the possibilities are endless. That means that side by side with an economist, a geneticist, and a physicist, you can find among the MacArthur fellows a farmer, a fisherman, a blacksmith, and a nurse. There are 732 people who have been selected to date, and there are 732 different stories of the ways in which these people are creative. There is simply no single profile. The youngest MacArthur fellow was 18; the oldest was 82. Fellows come from inside and outside the academy. We keep looking, but the strongest pattern is that there is no pattern.

Why don't businesspeople win the fellowship? Aren't they creative?

There's no question that people of extraordinary creativity and originality are in business. The founders of Google are incredible. So are Steve Jobs and so many others. Our reasoning is that the market is a very effective support system for the best ideas in business. We

Article at a Glance

One of the enduring problems in business today is how to find, nurture, and direct the people who will come up with the next Lipitor, Walkman, or iPod.

The MacArthur fellowships—popularly known as "genius grants"—have an elaborate selection process that can offer businesses valuable tips about how to find people of extraordinary talent and creativity.

Exceptionally original people are rare. The MacArthur selection committee reviews thousands of files to come up with just 25 or 30 fellows each year. If you think you can build a staff filled with innovative people, you're on the wrong track.

It's a common trap to give the limelight to people who are very good at promoting themselves and who are careful not to cause offense. Creative people ruffle a few feathers along the way. Value them—they are your potential winners.

serve those who do not fall under the influence of the market. That's not to say that artists don't live in the market economy, but we think that their driving motivations and rewards are different. And that's precisely why the money is an important part of the fellowship. Look at the freedom and time this relatively modest five-year fellowship – with absolutely no obligations – can confer on an artist or scientist

won a fellowship, they certainly talk about the pivotal role that the money will play. They talk much, much more about the affirmation the fellowship conveys. A MacArthur provides powerful validation that the fellow's work really matters, that other people have taken note. It opens doors for people, whatever the field. The award also represents a kind of personal fulfillment of a secret yearning. We all secretly

essential part of the definition of the program. Once a year we call people up and say, "Guess what? We've been looking at you, we think you're terrific, and we think you know far better than we do how best to use this award. You're going to get half a million dollars over the next five years, and you're never going to hear from us again." Think about that. It totally reverses the normal funder-recipient relationship.



whose ability to experiment is often constrained by the need to satisfy the requirements of outside funders. We do keep a lookout for entrepreneurs who are in their garages at the cusp of major new advances. In the main, though, venture capital folks get there before we do, as they should. I'm not saying that we will never give a MacArthur fellowship to someone in business. They're not officially exempt. But we have yet to consider a business nominee for whom the market wasn't a better source of support than we would be – and didn't offer far more resources than we ever could.

To judge from the way people talk about it, though, the award means more than just money.

Absolutely. The recognition is powerful. When people learn that they've

believe that we don't get sufficient approval for our work, that we are deserving of more money, status, and recognition than we have received. A fellowship is the acknowledgment by somebody else that you are fantastic – not your sibling, not your uncle, not your cousin, but you.

Don't businesspeople need this kind of affirmation?

Yes, certainly. But I don't think that we are the ones necessarily to provide it. Business can try to replicate our model, but it is not easy to do so. (See the sidebar "What Might Business Leaders Learn from the MacArthur Fellows Program?") That's because our model has elements that many in business might not feel totally comfortable with. There really are no strings attached to this fellowship – that's an es-

It's a wonderful experiment – and one, I suspect, that many in business might have trouble reproducing.

Are your reservations about supporting businesspeople also connected to the program's emphasis on social contribution?

Not really. A lot of businesses have, after all, made enormous social contributions. Our rule is that you've got to be doing something that adds to our wealth of knowledge or understanding of the world or to improvements in the ways we live. To take a trivial example, we aren't likely to give a fellowship to an inventor who's made a widget that allows homemakers to change the color of a washing machine at will, even if the science involved is elegant. We'd be far more interested if the widget cut the energy consumption of all household

What Might Business Leaders Learn from the MacArthur Fellows Program?

I am not an expert on business, but it seems to me that it would be hard for most businesses to replicate the MacArthur model perfectly. You really can't do it unless you can give some people in your organization unlimited time and a lot of money to do whatever they might want to do. How feasible is that in most contexts? Businesspeople have to be accountable to bankers and shareholders. Conditions are always attached to their funding. Even so, business leaders just might be able to provide a small number of people in their companies with more freedom than most are providing now.

What we have learned from the fellowship program is that very few people are extraordinarily creative. I can't tell you how many times we have tried to imagine a better, more efficient way to find the people we seek—to select 25 to 30 people a year without having to go through the enormously time-consuming process we follow and to involve hundreds of nominators and thousands of evaluators. The truth seems to be that the kind of creativity that leads to new things and important breakthroughs is extremely hard to find. So if, as a business, you're looking for a way to surround yourself with exceptionally creative people, forget it. You're on the wrong track. It won't happen. What you probably ought to do instead is to very carefully select those few you think are really creative and then give them the time and money and oxygen to flourish. Now, it may not be fashionable today to single out a few people, but it is one sure way to foster true originality and creativity.

Another thing we've learned over the years is that exceptionally creative people aren't always the obvious suspects. It is a common trap in all areas—I'm sure in business, too—to give the limelight to people whose success isn't the result of any special creativity on their part. They are just very good at promoting themselves. We have found that many of our winners are people whom others might never have thought of, at first, as MacArthur candidates. Many were unknown and ignored. So don't assume that you can figure out who your creative people are all by yourself. Listen to others and look in the least likely places. As a business, you will probably start your search inside the organization. But to get a really good fix on somebody on the inside, you might want to ask those on the outside. Extend your networks and try to get information from as many people as possible, just as we do with the many evaluation letters we seek.

Finally, when going outside for reviews, don't look for unanimity. Ours is not a popularity contest, and the creative people we look at have often ruffled a few feathers along the way. We have not been afraid of investing in such people, and if you want to find outstandingly creative people for your organization, you shouldn't be afraid either.

by not being afraid of it. It's still too soon to get a real sense of the full measure of our decisions—the MacArthur is only going into its 27th year. We're betting that 25 or 50 years from now a significant share of the fellows we have picked since the inception of the program will have made very, very important contributions to society.

Have you ever measured the productivity of the people who've won the MacArthur?

Over the years, we have asked for and commissioned voluntary assessments of the impact of the award on the fellows' work and lives. We have not, however, sought to measure "productivity." We pick people who are exceptional already, people who are visionary artists, brilliant scientists, inspiring people doing important things in the public arena. We would feel very uncomfortable taking credit for the next book, the next volume of poems, the next scientific discovery, or the next pieces of art. We believe that creativity is a qualitative and not a quantitative matter, and if you start counting books or counting prizes or anything else, you are fundamentally misunderstanding the nature of the creative process.

There is another reason we do not try to measure output. We think that by conferring a fellowship we transfer a heavy sense of responsibility to the individual. It's so easy when you get a regular grant to write a report, do an evaluation, and be done with it. You can't, however, get out from under the MacArthur fellowship that easily. For many, it follows them throughout their lives. Once you've won a MacArthur, the expectations that come from other people are quite high and remain high. I think many fellows feel impelled to prove to themselves and others that we were right in selecting them.

appliances in half. That would make a difference to the planet.

We also don't award people only for what they have done in the past. We certainly look at the body of work, but

we're betting on the outstanding work the fellows will do in the future. Recognition of that potential is where our risk taking comes in, and our view on this is that we must manage our risk

Who does the nominating?

Nominators work confidentially and anonymously. The anonymity of the nominators is key, because if you can't find them, you can't launch a network-

ing campaign to get selected. Throughout the year, the fellowship program invites hundreds of nominators from a great many fields, each of whom serves a single eight-week term. During the

the year, this external selection committee meets in full-day sessions to review and evaluate the merits of those nominees whose files have “ripened” – the ones who come out really singing to us

cist—people who are themselves extraordinarily interesting, extremely successful and well connected, and as close to Renaissance people as one can find. When these folks get together, their meetings are magical events: Their exchanges and deliberations cross many disciplines and are almost indescribably rich and deep. Putting together a group of selectors can be as challenging as picking a class of fellows.

The MacArthur represents the fulfillment of a secret yearning. We all secretly believe that we don't get sufficient approval for our work, that we are deserving of more money, status, and recognition than we have received.

course of a year, nominators come up with hundreds of names – sometimes 1,000 or more. Among these nominations, we focus on a fairly large group who appear most compelling as candidates, and we begin to “develop” their files. At any given moment we’re actively developing some 300 to 400 files, which in each case involves reviewing materials written by the person, listening to his music, looking at her art, and so on. Developing files also requires seeking letters from as many peer and expert evaluators as we can identify, sometimes 20, 30, or more. These evaluators may be colleagues of the nominee; they are always people who know the field and the nominee’s standing in that field. If we’re looking at a violin maker, for example, we will seek musicians and other violin makers as evaluators; we will also talk to experts in acoustics, in design, and in woodworking. To make sure that the evaluators feel as free to comment as possible, we pledge that no one outside the fellowship selection process will ever see their letters. That’s how we encourage and ensure responses that are often a lot more direct and helpful than the typical tenure or employment reference letter.

as being potentially quite astonishing. Selectors are the most important players in the process. There are about a dozen of them at any one time, and they serve three- to five-year terms. A group of selectors might include a philosopher, an artist, a futurist, a molecular biologist, a lawyer, a journalist, an astrophysi-

How do you find nominators and selectors?

The whole process is very fluid. Nominators are suggested by the selectors, by other nominators, by board members, by evaluators, and by members of the program staff. Many others are identified among our very large pool of evaluators each year. Our database of potential nominators is quite large and always growing. We also do specific research in new areas where we have not yet had success finding fellows, and we

COLLABORATES

to gain new perspectives

across continents

to create the next big thing

to surprise the competition, yet again

to do what's right, not what's easy



Duke University's Fuqua School of Business educates leaders at all stages of their careers. Whether you're a full-time MBA student, a professional earning an executive MBA to accelerate your career, or part of a team in an executive education program, you'll gain a broader, more global perspective through an innovative curriculum and instruction by a top research faculty.



DAYTIME MBA | EXECUTIVE MBA | EXECUTIVE EDUCATION

fuqua.duke.edu

How do you actually choose the fellows?

Final recommendations are made to the foundation's board by a group of people we call selectors. Throughout

invite people to be nominators in such areas. The selectors, for their part, are formally appointed by the board of the foundation, after being vetted by the foundation's president, the chair of the selection committee, and me.

There is something in the air in this country that encourages those who participate in the program to keep our confidence—to serve anonymously. This

Women are every bit as creative as men—just look at those who do receive MacArthur fellowships each year. It is possible that differences in career paths and competing demands on their time still hold women back from taking unconventional directions and challenging accepted boundaries. The gap in numbers of nominations is closing, however, and that is encouraging. Personally, I

**This is a very hard program to game—
you just can't find anyone to influence.
The only person you can get to is me, and the
beauty of it is that I can't nominate anyone.**

is really quite extraordinary and not, from my experience, common in the United States or anywhere else. Selectors—and even nominators and evaluators—by and large refrain from revealing their roles in our process, even years out. The only time I've heard of a selector going public was in an obituary, when the family members were so proud of his involvement in the MacArthur selection process that they wrote about it at the time of his death. Maintaining confidentiality rarely happens in most settings. It does here in large part because participants recognize the importance of confidentiality in ensuring the program's objectivity. As a result, this is a very hard program to game—you just can't find anyone to influence. The only person in the program you can get to is me, and the beauty of it is that I can't nominate anyone. So people can tell me anything they want.

Do women have greater difficulty winning a MacArthur?

The number of woman fellows has increased significantly over time as women's roles in society have shifted. Women are still not nominated as frequently as men, even though we work hard to ensure that they are as well represented among the nominators.

get very excited when a majority of women are selected as fellows in a particular year. That's happened only once in my ten years here and only a couple of times before that. But the numbers of men and women are usually very close now.

Do you specifically look for risk takers?

It's part of the equation in most instances. I think for some people, perhaps for most, trying something new and approaching challenges freshly requires an element of risk taking. A skydiver is a risk taker too, daring and full of guts, but he or she is not likely to capture our attention. On second thought, I can think of an instance or two where a skydiver might just be of interest to us, but I'd rather leave it at that. Typically, a MacArthur involves risk taking in the context of being smart and driven to move from what is tried and comfortable, to get off center. We see this kind of mix in a lot of fellows. But there are also many cases in which risk taking, at least as it is commonly understood, is not at the center of the extraordinary creativity we reward. For example, we selected a scholar of the classics who was also a papyrologist and an expert in the art and craft of rescuing damaged texts. He opened new win-

dows for us all, but his risk taking—such as it is—is subtle. It is just too simplistic to say categorically that all creative people are risk takers.

What is the most unusual response you've heard when you've called a winner?

When I tell people I'm calling from the MacArthur Fellows Program, there's often a stunned silence for half a minute or so. Remember, unlike Oscar winners and most Nobel laureates, these people have absolutely no idea they are under consideration. When I first started making these calls, a few people almost choked or fainted. I now make sure that they pull over if they are driving a car, or that they sit down, put a baby down if they're holding one, and take a deep breath. In New York a couple of years ago, a woman was standing near a bed store. She asked me to give her a moment, walked into the store, lay down on a mattress, and continued the conversation. Surprisingly, nobody hangs up. It gets back, perhaps, to the fact that in all of us there is the belief that the magic could happen to us. It's a hope that many harbor.

On average, women tend to be more open in the one conversation we have on the phone. They share their dreams. Women have told me that the MacArthur is a suit of armor, that the fellowship is a gift of wings, that it will break the trade-offs they have had to make all their lives. Men often talk about it as leveling the playing field in important ways, and as freeing them to be still bolder and to take more risks. Both men and women frequently say the timing of the award was perfect. In fact, I don't remember anyone's saying that it was the wrong time, that the award should have been given years earlier. We don't hear that even from the older fellows. A MacArthur can be—often is—life changing. Who couldn't use a little more recognition and money at any time in their lives? □

Reprint R0705H

To order, see page 147.

Glasgow Hamburg Moscow
 Manchester
 Birmingham Düsseldorf
 London Heathrow Frankfurt
 London Gatwick
 Paris Munich Vienna Istanbul
 Zurich Milan Venice
 Nice Rome Larnaca
 Athens
 New York
 Houston†
 Casablanca
 Tunis
 Tripoli
 Malta
 Alexandria
 Cairo
 Beirut
 Damascus
 Kuwait
 Bahrain
 Doha
 Amman
 Dammam
 Jeddah
 Riyadh
 Tehran
 Peshawar
 Lahore
 Karachi
 Muscat
 Dubai
 Beijing
 Shanghai
 Seoul
 Osaka
 Hong Kong
 Nagoya
 Delhi
 Kolkata
 Dhaka
 Manila
 Mumbai

Our world.

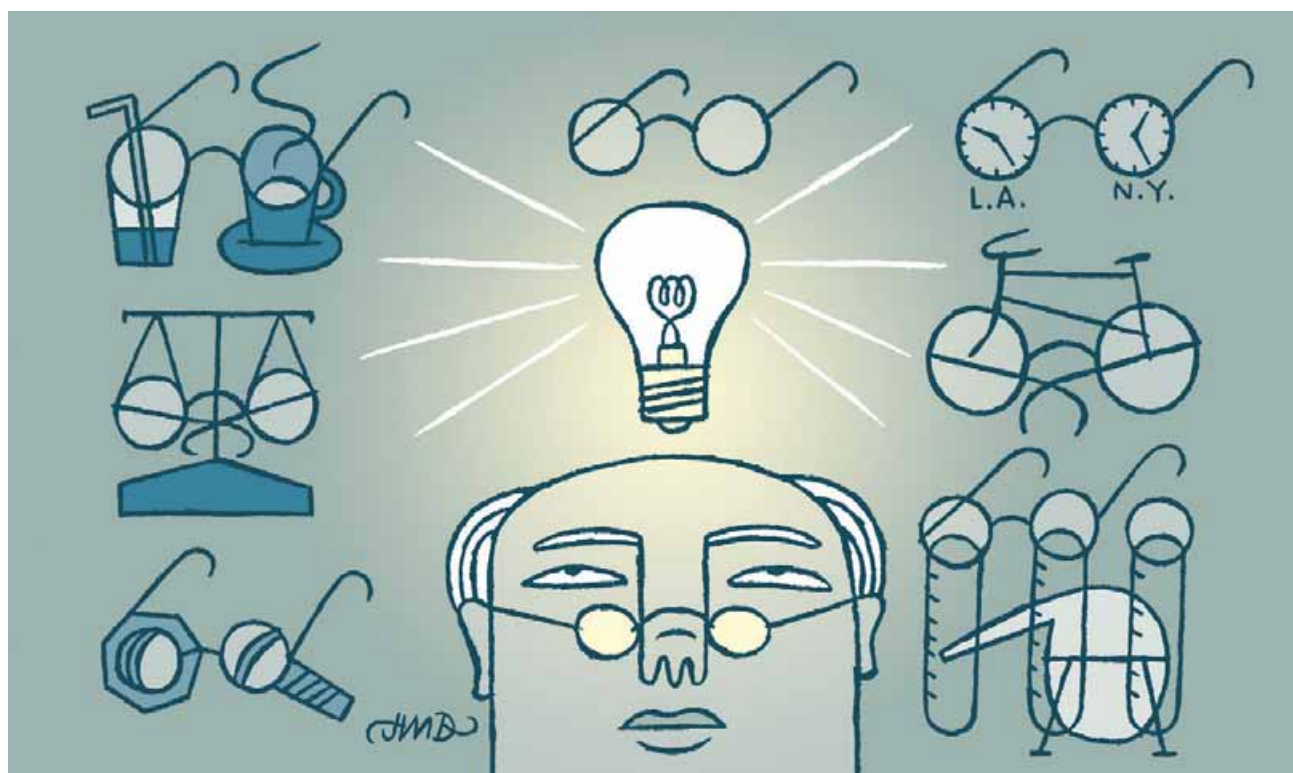
Discover the Emirates global network.

A ripple begins as a single droplet, before its beautiful effect can be seen all across the water. Emirates now flies to over 80 destinations spanning five continents. Dropping in just about everywhere.

Fly Emirates. Keep discovering.

Accra
 Abidjan
 Lagos
 Khartoum
 Sanaa
 Addis Ababa
 Entebbe
 Nairobi
 Dar es Salaam
 Johannesburg
 Bangalore
 Cochin
 Thiruvananthapuram
 Colombo
 Malé
 Seychelles
 Mauritius
 Hyderabad
 Chennai
 Singapore
 Jakarta
 Kuala Lumpur
 Bangkok
 Perth
 Melbourne
 Auckland
 Brisbane
 Sydney
 Christchurch





The Value Captor's Process

Getting the Most out of Your New Business Ventures

by Rita Gunther McGrath and Thomas Keil

EXECUTIVES CHRONICALLY COMPLAIN about their companies' sorry track records in creating new businesses, for seemingly good reasons. The proportion of ventures that are actually launched is low, and the costs of not just the failures but also the successes all too often dwarf original estimates. Indeed, some studies have found that a firm typically has to come up with thousands of ideas before achieving even one commercial success.

The high failure rate is usually chalked up to the fundamental uncertainty of the process. Our research suggests, however, that the disappointing amount of value generated by new business development is rooted in flawed ways of evaluating and managing ventures. (See the exhibit "Ten Telltale Signs of a Flawed Venturing Process.") These are based on a specious assumption: that the

Jean-Manuel Duvivier

only worthwhile outcome of investment in a venture is a new business. Far too little effort is made to extract value from the so-called failures (ventures that don't meet market, margin, or growth goals), the misfits (ventures that ultimately don't mesh with the overall corporate strategy), and the unexpected by-products of failures (new technologies, capabilities, or knowledge). By re-designing the process so that choices other than "go" (continue toward launch of a new business) and "no-go" (kill the venture) are fully considered along the way, companies can improve their returns on investment in innovation.

Alternatives to go and no-go include recycling the venture by aiming it at a new target market, spinning it off to other owners or a joint venture, spinning it in to an established business unit, and salvaging useful elements such as technologies, capabilities, knowledge, equipment, reputation, network connections, and patents.

Our conclusions are based on extensive research into the corporate venturing process that we conducted individually or together over the past 16 years. The dozens of companies we studied include 3M, Air Products and Chemicals, Deutsche Telekom, DuPont, Hewlett-Packard, IBM, Intel, Microsoft, Nokia, Siemens, Swiss Re, and Texas Instruments. We observed that firms that excel in extracting value from their ventures have created formal processes to systematically mine both successes and failures. This article explores the distinctive mind-set and practices of these value captors.

The Go/No-Go Approach

Procedures for new business development that call on managers to make go/no-go decisions regularly during the life of a venture became popular in the early 1990s. They typically divide the process into a handful of stages: idea generation, preliminary investigation, making a detailed case for the proposed business, development, testing, and business launch. At the end of each

stage a designated group of reviewers evaluates the venture's progress in achieving goals that were spelled out in advance and decides whether the venture should be allowed to move to the next stage. One of the main attractions of this approach is that it provides a disciplined means of winnowing out less-promising, riskier projects sooner rather than later. Colossal failures – including Motorola's Iridium satellite phone project and Exxon's misadventures in oil shale – are a testament to the need for such a mechanism.

A fundamental flaw in go/no-go decision making is the assumption that many critical elements of the future business can be defined in advance. This presumes that the venture team can specify at the outset who the intended users are, what benefits they will receive, how the business will be competitively positioned, and what should be included in a detailed list of "must have" and "would like to have" features. This kind of thinking overlooks the critical role of learning. As a venture progresses, its team often discovers that the offering appeals to a different set of users or that the desirable or deliverable benefits have changed, making it necessary to revise the competitive positioning of the business.

Ventures should be treated like scientific experiments, which involve identifying gaps in knowledge, developing a hypothesis, designing a test, conducting the experiment, and evaluating the results. If the hypothesis is supported, further research along the same lines can be undertaken with greater confidence. If it is not, the scientist will reflect on the possible reasons and then either stop or redesign the experiment. Even a hypothesis that is not borne out can be valuable, because it offers new insights.

Budget approval processes that require proponents of a new business idea to commit to a return on investment (or net present value) goal inhibit managers from approaching ventures in this fashion. Everyone is forced to focus on success or failure in achieving a specific business outcome rather than on in-

sights arising from the hypothesis that led to the venture. It makes much more sense to focus on the *option value* of a venture – the value of the opportunities it may open up, not all of which are known at the outset.

The experience of a multinational financial services firm illustrates the problems with the go/no-go approach. In the late 1980s this company formed a venture to enter the emerging market for information on household purchases. The plan: In return for discounts and other benefits, supermarket customers would use affinity cards at checkout that would allow their purchases to be tracked. The financial services company would aggregate the data and sell them to large packaged goods manufacturers for use in fine-tuning promotional offers. The company spent \$130 million to launch the program throughout the United States.

Article at a Glance

Disappointing returns on new business ventures are rooted in widespread management and evaluation practices that emphasize two choices at the end of each stage: "go" (continue down the road toward launching the business) and "no go" (kill the venture).

Recycling a venture to aim it at a new target market, spinning it off, folding it into an established business unit, and salvaging elements that might be useful elsewhere in the company are often-overlooked options that should be considered.

A fundamental flaw in the go/no-go approach is the assumption that critical elements of the future business can be defined in advance. Ventures should be treated like scientific experiments: They should be structured to test hypotheses and to change course if the tests disprove original assumptions.

This discovery-driven approach requires significantly different methods of forging ties between ventures and the rest of the organization, measuring progress, and funding and staffing.

Ten Telltale Signs of a Flawed Venturing Process

1. The plan for an innovation is all or nothing; it looks only at the project as originally conceived and not at underlying capabilities that may be created.
2. No explicit plan has been made to articulate and test assumptions and update the project according to what is learned.
3. The project's initial approval includes full funding to market launch (with no requirement that successfully achieved milestones confirm the project's viability along the way).
4. The project is evaluated as established businesses are—on a calendar schedule rather than according to milestones achieved.
5. Project team members are rewarded only if the venture is launched as a business; they suffer negative consequences if the project is killed.
6. Once approved, the project is under pressure from senior executives to achieve large revenues or market share quickly.
7. The project is being managed in a "skunk works," isolated from other parts of the company.
8. Although they may have a great track record in the core business, team members have little experience with uncertain or ambiguous situations.
9. The CEO and senior executives publicly maintain that the project will compensate for core business performance shortfalls in the near term.
10. Progress in achieving the plan's goals is the only way to measure project benefits. Intangible assets, new opportunities uncovered, or platforms on which future ideas could build are neither identified nor monitored.

Its key mistake was trying to sign up the maximum number of cardholders nationwide rather than trying to achieve critical mass in individual local markets—which, as it subsequently learned, was what mattered to packaged goods manufacturers.

When a crisis in another division caused a cash crunch, the company's executives decided that they didn't have the resources to develop the venture into a viable business. In 1992 they simply shut it down, selling the technology and other assets for a pittance and suffering a huge loss. As a result, the company missed out on an enormous opportunity. Today packaged goods manufacturers spend approximately \$36 billion annually on trade promotions in the United States, according to various industry estimates. If the company had considered other options—such as a joint venture with a software or information firm that had more experience in the field—it might have established a formidable position years before competitors entered the market and might today have a business with billions of dollars in revenues. At a minimum, it could have used the venture's discoveries (such as data compression algorithms) to expand or enhance its mainstay lending and credit card businesses or, alternatively, it could have licensed them to others.

Overlooked Choices

Let's now examine in greater detail why several options available to any company involved in venturing are so often disregarded.

Recycling. In the course of finding out that its original concept is flawed, a venture team sometimes discovers another promising possibility. Recycling involves redirecting a venture to focus on the new opportunity. Often the original team remains intact. However, the venture's objectives, scope, and target market are altered, and as a result, new capabilities may be needed.

Of course, some legendary entrepreneurs achieved success precisely be-

cause of their willingness to change course when the idea they were pursuing ran into trouble or a more promising opportunity emerged. But established large companies, with their systems, bureaucracies, and fear of throwing good money after bad, are radically different animals. The pressure to meet budget or achieve a plan's goals may cause a venture team to fixate too early on specific target markets or opportunities.

Value captors, in contrast, understand that the ability to capitalize on what a venture team learns along the way has to be built into their management processes. They realize that before abandoning a venture, they should explore any new opportunities it may have unearthed. As Thomas M. Connelly, the chief innovation officer at DuPont, observes, "It is important to recognize that most new ventures go through radical redirects along the path to success."

Spinning off or licensing. A venture may turn out not to be a strategic fit. In some instances the customer set or business model differs too radically from that of the parent company. In others the opportunity ends up being too small to justify the resources needed to develop it. Nonetheless, such projects may have a bright future outside the company. Venture capitalists or hedge funds might be interested in backing them as independent entities. Other companies might be interested in them as joint ventures. And even if an initiative has no future as a stand-alone business, someone might want to license its intellectual property.

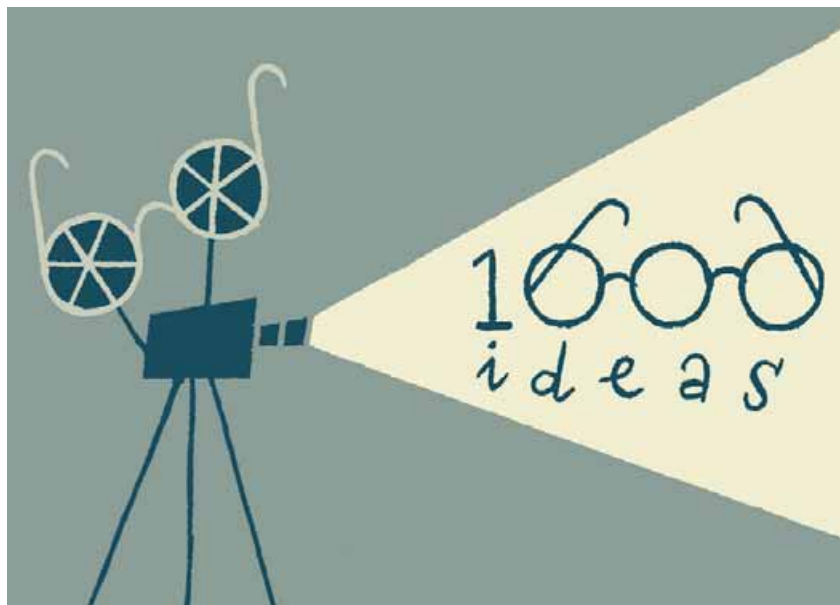
Why do firms pass up such opportunities? Corporate managers may be reluctant to spin off a venture for fear that if it succeeds, questions will be raised about how they could have missed such a good prospect. Sometimes companies are nervous about parting with intellectual property and assets that competitors might use against them. In other cases they simply lack the capabilities required to spin off ventures or license their know-how. One way to overcome such hurdles is

to create a dedicated unit with the expertise, connections, and mandate to engineer spin-offs and license know-how. Such groups exist at Microsoft and Siemens, for instance.

Spinning in. Sometimes, when basic elements of a venture's concept have changed along the way, launching a stand-alone business no longer makes sense even if it is a strategic fit and has developed or nearly developed marketable products and services. The target market may not be sufficiently novel or big to justify creating a separate business, and the venture may now need different capabilities from those originally envisioned. Value captors identify where else in the corporation the idea might have merit and move it there. This may sound like an unexceptional feat, but, surprisingly, it rarely happens.

Why? The managers of established businesses and those of ventures may not know enough about one another to recognize a match. Even when they do, the business managers sometimes fear that they are being offered the leavings of a failed program. Sometimes they resist adopting anything that was “not invented here.” And some fear the hassles of trying to meld a venture with a business that has a different scale and rhythm and, as is often the case, distinct systems for accounting, reporting, budgeting, and managing people.

Value captors employ consistent back-office systems across their organizations so that combining parts in new ways is straightforward. In addition, they foster networks that help established business leaders and venture teams to form personal relationships and keep abreast of areas of mutual interest. One head of a venture group set up an exchange where anyone in the company could post a technical problem and others could offer solutions.



The exchange was an eye-opener for venture teams: They'd had no idea just how many solutions they had developed that could help other units in the company.

Senior-level involvement in the spin-in process is also extremely helpful. When IBM decides to fold a venture in its “emerging business opportunities” program into an established operation, J. Bruce Harreld, the company's senior vice president for marketing and strategy, gets personally involved.

Salvaging. Of course, some ventures are failures in the sense that they do not create viable products or services. Even these projects, though, may contain assets of some value internally. Unlike spinning in, which involves moving a venture more or less intact to some other part of the organization, salvaging breaks up the venture and harvests its constituent elements for use elsewhere in the company. These might include intellectual property such as patents, processes, and brands; specialized equipment; specific kinds of expertise; network ties; and the abil-

ity to build and lead teams under highly uncertain conditions.

In companies where return on investment or payback time drives everything, there is often little incentive to search for the gems hidden within a venture that has badly missed its targets. The leaders of such ventures have typically lost so much credibility that they are not taken seriously. And, unfortunately, in the final days of a failing venture many good people on the team jump ship, taking with them knowledge of the gems worth salvaging.

Value captors, however, pay attention to what is being learned in the venture all along the way. (See the exhibit “The Value Captor's Process.”) Their senior executives make such learning a priority in the review and funding process. In addition, some value captors have formal processes for taking stock of potentially valuable assets developed by failed ventures and identifying where in the company they could be deployed. At Nokia this effort is led by a venture board, which consists of senior corporate executives and the head of the

Rita Gunther McGrath (rdm20@columbia.edu) is an associate professor of management at Columbia Business School, in New York. She has coauthored five previous *Harvard Business Review* articles and two books: *The Entrepreneurial Mindset* (Harvard Business School Press, 2000) and *MarketBusters: 40 Strategic Moves That Drive Exceptional Business Growth* (Harvard Business School Press, 2005). Thomas Keil (thomas.keil@tkk.fi) is a professor of strategic management at Helsinki University of Technology, in Finland, and the academic and managing director of the university's TKK Executive School of Business. Both advise organizations in the areas of innovation, strategy, and corporate growth.

venturing unit. The browser technology that Nokia's core mobile phones business group now uses in its products came from such a postmortem.

Avoiding the Go/No-Go Trap

Managing ventures as open-ended, iterative experiments rather than taking a go/no-go approach requires different relationships between ventures and the rest of the company and new ways of measuring progress, making funding decisions, and staffing projects. Let's look at these one by one.

Organizational ties. When locating their ventures, companies often make one of two common mistakes: They either isolate the projects from established businesses totally or they integrate them too tightly. In contrast, value captors strive to strike a balance between giving a venture enough autonomy to thrive and maintaining links

with the rest of the corporation sufficient to facilitate a constructive two-way flow of ideas and to allow the whole venture or some of its elements to be folded into established businesses if need be. They accomplish this by involving other parts of the organization in the review process and, in some cases, in the launch of the venture as a commercial business.

The reviews. The process for reviewing ventures should encourage participants to consider a full range of choices for proceeding – which the go/no-go approach often does not. Typically, those entrusted with reviewing a venture in the go/no-go scenario are senior executives, such as the chief technology officer and the chief financial officer, and the committee that evaluates capital expenditures. For such a time-pressed group, a no-go decision is often the most expedient way to deal with a struggling venture that isn't meeting

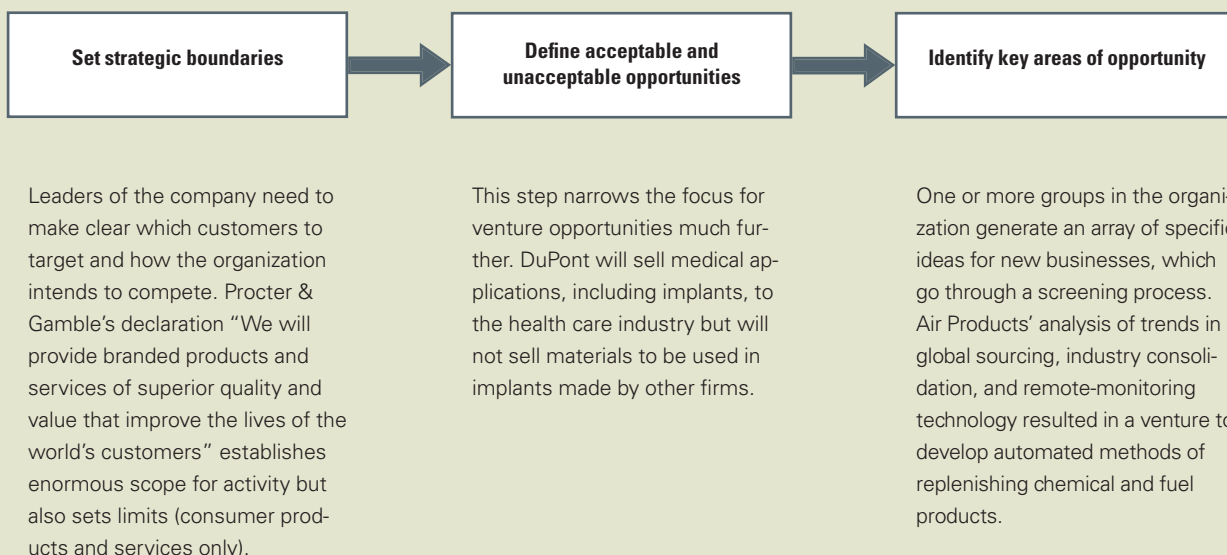
an objective—a technical goal, a sale to an initial customer, spending limits, or, most important, the schedule for generating a payoff.

Value captors do two things differently. First, they make sure that people from units throughout the corporation that have a potential future interest in the venture are involved in the review process. Second, financial criteria do not dominate their deliberations.

At Texas Instruments, venture boards are made up of people from core businesses, R&D, marketing, and sales. The core businesses participate because discoveries in the ventures may have implications for their markets. R&D is involved to assist the venture with any technological challenges and to keep tabs on technologies in the pipeline that may be relevant to future opportunities. Marketing can help identify

The Value Captor's Process

The conventional venturing process is often depicted as a funnel: Lots of proposals enter at the top, and only a handful emerge from the bottom. In contrast, the processes used by value captors open up more options at each stage of the venture's progress and involve more players in different functional and business groups across the corporation.



how the venture's discoveries might satisfy customers' needs – including some the venture team may not have considered. Account representatives may be able to find customer sponsors for the venture's activities.

Other companies, such as Nokia and Fortis, the Benelux-based financial services giant, add to this mix representatives of departments such as human resources, legal, and intellectual property and managers of other ventures. The perspectives of peers from other ventures are important because they understand the challenges of breaking into innovative markets. HR can offer insight into future staffing requirements, which will obviously vary depending on how the venture evolves. In addition, HR can help a company retain the talented people on venture teams by working to overcome the perception that participating in ventures is a major career risk. The legal and intellec-

tual property departments can ensure that the venture's innovations are protected if they are brought to market and can also see how the innovations are relevant to other opportunities of interest to the organization.

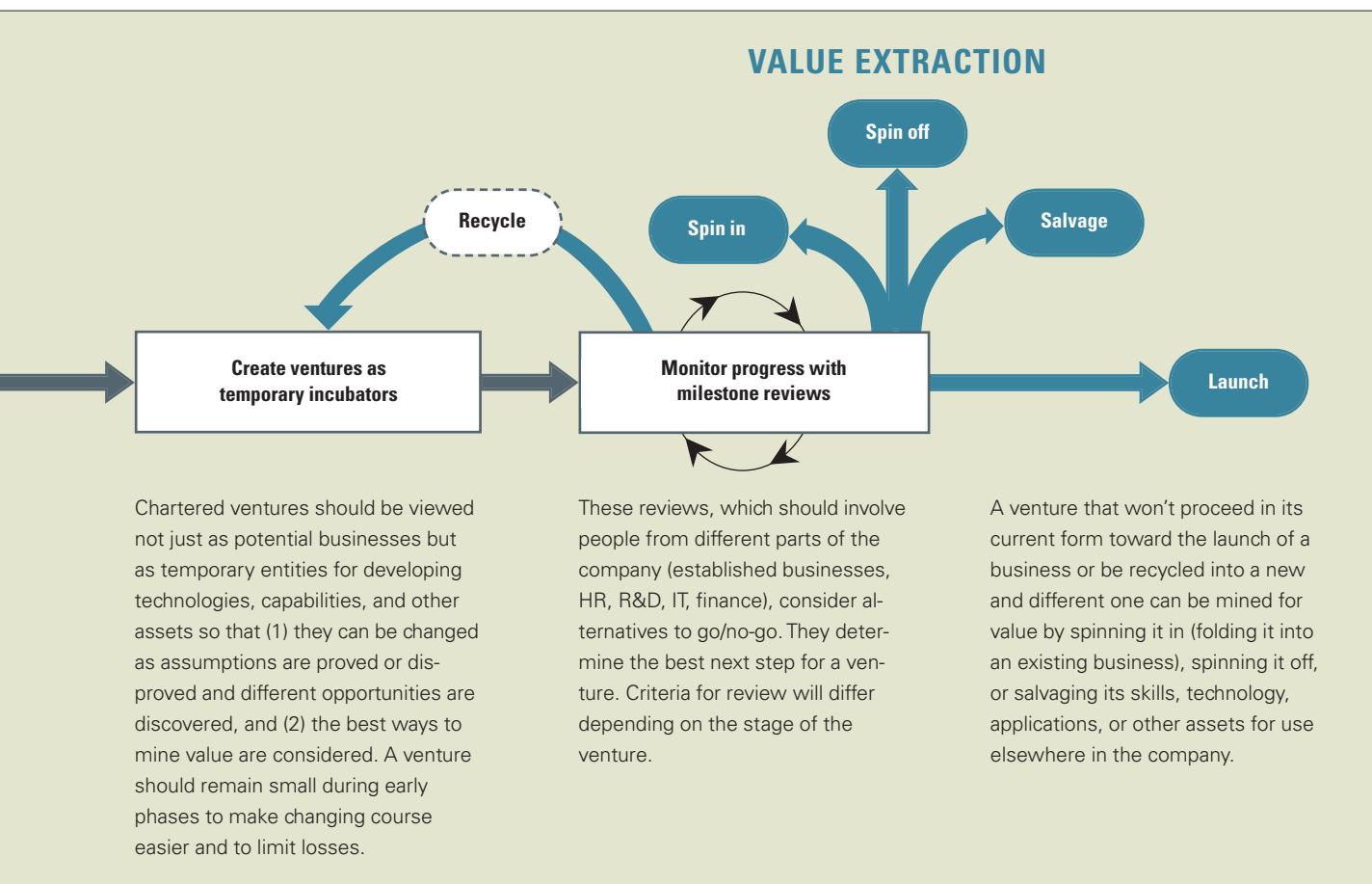
The launch. Companies with go/no-go processes often think that the scale-up and commercialization stage is just a

Air Products and IBM, however, recognize that the talents and resources required to test and flesh out a concept may differ enormously from those needed to launch it as a business. They also understand that the launch may require different people, a different organizational structure, and, in many cases, the assistance of existing businesses.

When making investments on the basis of a plan, a firm may begin treating the plan as immutable. This makes it easy to overlook evidence contradicting the initial assumptions.

matter of adding resources to the existing project. Because they view participation in the launch and running the business as just rewards for the people who successfully developed the project, they often entrust commercialization to the same team. Value captors such as

At Air Products, drawing from all the company's capabilities to solve customers' problems is central to the strategy. The company therefore mandates that new ventures within its core chemicals and materials areas be commercialized by an established business



group. When a venture is ready to be launched, it is transferred from the incubator organization to the group deemed best equipped to assist it in terms of assets, relationships, and market insights. Projects with business models or technologies that differ significantly from those of the established enterprises are often launched in joint ventures with partners that can provide capabilities Air Products lacks.

At IBM, the goal of the emerging business opportunities program is to create radically new businesses, so it stands to reason that the company does not entrust the launch of EBOs to its established enterprises. However, it does recognize that the latter may have resources critical to a successful launch. So when an EBO is ready for launch, IBM transfers those resources – which may include whole units – to the venture.

Measuring progress. Given the uncertainties involved in starting new ventures, it is remarkable how many companies persist in evaluating their progress according to the achievement of detailed goals that were established at the outset and were based on yet-to-be-proven assumptions. There are three problems with assessing a venture's progress in this manner. First, it's common for the assumptions underlying a goal to be wrong or circumstances to change. Second, as a firm makes investments on the basis of a plan, it all too often begins treating the plan as immutable, forgetting that it was based on unproven assumptions. This makes it easy to overlook evidence that contradicts those assumptions. Third, because success is defined as meeting the plan's goals, deviating from the plan is interpreted negatively, which discourages people from challenging its validity. The bottom line: "Making plan" as a measure of a venture's success inhibits learning.

An alternative to the go/no-go approach is to make learning a central purpose of the venture plan. In a *discovery-driven* plan, measuring progress consists of validating assumptions as quickly and cheaply as possible and then revising the plan as necessary at key mile-

How Texas Instruments Discovered a Promising Business

The way Texas Instruments entered the market for radio frequency identification (RFID) technology illustrates the benefits of the discovery-driven approach to new business ventures. In 1989 Jerry Junkins, then TI's CEO, launched a strategic initiative whose aim was to transform the company from a manufacturer of commodity electronics into a much more creative producer of innovative, higher-margin products. As part of this drive, some senior executives proposed investing \$50 million to commercialize R&D efforts in RFID.

Junkins, however, was uncomfortable with committing such a large amount to an emerging technology. An investment to develop a major application – tracking airline cargo, for example – would almost certainly have caused TI's executive committee to expect a respectable return on investment within three years, which Junkins felt was unrealistic. So Junkins and Dave Martin, a TI vice president, requested that a team test the technology in a small market with customers who would be willing to pay for a solution to a real problem.

The team came back with a proposal to develop an RFID-based system that would enable European farmers to prove their compliance with regulations limiting the number of animals per hectare. Had TI based its decision to invest in the venture on whether the market size and potential payback were sufficiently large and the level of risk sufficiently low (common criteria in the go/no-go approach), the company probably would not have funded the initial effort. Instead TI's leaders saw it as a contained experiment for testing hypotheses easily and cheaply and decided to move forward.

The animal-tracking experiment was successful in that the venture started to generate revenue and gain traction in a new area for the company. The team also learned a great deal about how the technology worked in the field and what improvements customers sought. Emboldened, the team asked Junkins for a significant investment to develop new applications – but the timing wasn't fortuitous. TI's core semiconductor business was having trouble keeping up with a surge in demand and needed to build expensive new capacity. As a result, Junkins wanted the venture to continue cautiously.

This decision prompted the team to change its business model: For the time being, TI would leave the job of designing applications to value-added resellers and systems integrators, to whom it would supply RFID chips. During this phase the chips' growing sales volume caused unit costs to fall; standards began to emerge; and awareness of RFID technology spread. As a result, TI was receptive when a General Motors executive called on Martin for help in addressing the vexing problem of car theft. GM wanted to know if there was a way to embed an RFID chip in a key so that no key without the chip could start the car. The ignition immobilizer, introduced in 1993, was TI's first major RFID application.

Others followed, including highway toll collection systems and Exxon Mobil's Speedpass, which allow people to make credit or debit card purchases without having to sign a receipt or swipe a card through a reader. It's safe to say that if TI had not taken a discovery-driven approach to developing the business, it would not have a leading position in a highly promising market today. The applications that turned out to be significant profit generators were not on the original list of possibilities. Had management blessed the initial proposal, the venture would probably have started by focusing on a big market, where the costs and challenges would have been great – making it likely that the venture would have been either terminated or an expensive failure.

stones. (See “Discovery-Driven Planning,” by Rita Gunther McGrath and Ian C. MacMillan, HBR July-August 1995.) Assumptions are documented, debated, and monitored on an ongoing basis. When reality proves to be different (which it almost invariably does), the venture team can revise its assumptions collectively. Comparing original assumptions with later discoveries is often the basis for redirecting or changing the scope of a venture and can significantly increase the odds of achieving success.

Funding. When first approving a venture, some companies unwisely fund it to commercial launch without building in checkpoints that will prompt a change in course if something new is learned along the way. Companies often make this mistake when a venture is targeting a market in which the first-mover advantages appear to be significant, tempting executives to pour resources into the project so that it can proceed at maximum speed. In other cases managers wrongly believe that a venture can be treated like a conventional line extension with predictable funding needs. Full funding can have negative consequences: It can cause a team to escalate its commitment to a single course of action – encouraging the team to be spendthrift – when it should be striving to keep all its options open. One of the commandments for ventures should be “Fail cheap, fail fast, move on.”

Ventures should be thought of as *real options*: investments that give you the right but not the obligation to participate in an opportunity later on. A real option is valuable when you can find a way to minimize the amount and downside risk of your investment and simultaneously gain access to a potentially significant opportunity. This approach encourages companies to conduct a series of low-cost experiments to test hypotheses – rather than risk big investments on a single unknown – which improves the odds of discovering a high-potential idea or application.

This way of thinking can be embedded in the venture-funding process by applying two principles. The first is

fund only to the next milestone. You can think of this as buying an option on the achievement of the milestone, at which point you can choose to continue, to stop, or to take an alternative action. The second principle is *position the inexpensive milestones early in the process* (to the extent that you can) and defer the more expensive or fixed commitments as long as possible. This saves money if the venture is terminated and ensures that by the time you incur large sunk costs, you are doing so with more knowledge.

Staffing. We’ve observed three widespread employment practices that make it difficult to reap the full benefits of ventures:

- Overpopulating a venture team with strong performers in a core business who have little experience in dealing with the unpredictability of ventures. Consider a Six Sigma black belt – an expert in stamping out deviations from plan. Chances are that such a person would be so disturbed by a venture’s changes of course that he or she would overlook the new opportunities they often reveal.

- Staffing the team primarily with volunteers who want to work on projects they find interesting. These enthusiasts can become too attached to a product or a technology, making them resistant to recycling the venture if the initial concept proves flawed. They may also be unwilling to move beyond the venture unit. Allowing the venture organization to be a career destination, however, can impede the transfer of its intellectual capital to other parts of the company.

- Unintentionally discouraging the best, brightest, and most ambitious from working on ventures. In a culture where making plan is a mark of success, high performers avoid projects that seldom deliver reliably or predictably. This may lead to second-class status for venture teams, which can make establishing productive relations with other parts of the company and spinning in or salvaging ventures more difficult.

Value captors engage in four people-management practices that dif-

ferentiate them from their less effective counterparts.

- They make sure that the venture group includes some strong players who have experience with the unpredictability of new business launches and can help neophytes learn the art of managing ventures.

- They consider venturing experience a career asset; most make a stint in the venture group a requirement for rapid advancement.

- They stipulate that such stints are finite and methodically transfer people with venture experience to the mainstream organization, where they can put their valuable knowledge, skills, and capabilities to work rejuvenating the core business.

- They are careful to distinguish between the performance of an individual on the venture team and the outcome of the venture. This approach helps in retaining good people who might otherwise feel stigmatized by the failure of a venture and leave.

Air Products is a company that employs these practices. Its director of new business development, Ron Pierantozzi, is a 30-year veteran of the firm with extensive experience in creating new businesses. To obtain a broad range of expertise and perspectives, he recruits people with diverse backgrounds – from engineers to entrepreneurs to former government officials – both inside and outside the company. It’s made clear at the outset that they will be redeployed in the established businesses within four years. When the established businesses are considering candidates to fill positions, they view experience in Pierantozzi’s group as a big plus. And association with a failed venture is no stigma: Air Products is disciplined in differentiating between people who failed and ventures that failed.

...

Becoming a value captor can be a major undertaking. Tantamount to a change management program, it can take five years or more to complete. Of course, that depends on your starting point. If

you don't even have a dedicated business development unit that operates like a venture capital group, you're probably at square one.

What are the signs that you should consider taking this journey? If your innovation pipeline is dry, if promising projects are being strangled because they have not delivered a payback in two years, or if a competitor has made a fabulous business out of a slightly different version of an idea that you abandoned, explore the value captor's path. That path is defined: The tools – for writing a discovery-driven plan, for conducting reviews, for figuring out how to test assumptions and draw conclusions from those tests – are readily available and fairly easy to use.

What's much harder is altering conventions and structures that drive how people behave. It can be extremely difficult to convince managers that failing cheaply and learning from it is a great outcome in a highly uncertain environment when they have been trained to

believe that failure to make plan or hit the numbers is bad. Similarly, rerouting career paths, forging personal networks, and reforming the budget process along the lines outlined above are easier said than done.

Finding the right manager to champion this transformation can also be a big challenge. The ideal person will have a proven track record in creating businesses, deep knowledge of the company, and strong relationships throughout the organization. He or she must be entrepreneurial yet command respect across the board and must also have the confidence and the authority to stand firm. For these reasons, companies should choose insiders for the job if they can. Sometimes they can't; roughly a third of the companies we've observed went outside.

Even if the path to becoming a value captor is a long one, you don't have to wait until the end to reap substantial benefits. Though IBM launched its emerging business opportunities pro-

gram in 2000, EBO has only now become fully embedded in the company, IBM executives say. Yet by 2003 the enterprises launched through the program were collectively generating billions of dollars in revenues.

Value captors recognize that the number of new businesses launched and the revenues and profits they generate, although important, are not alone the measure of success: The established businesses must wholeheartedly subscribe to the discovery-driven approach to innovation. When this happens, learning—and capitalizing on learning—become as important as making the numbers. When ventures and established businesses work together to suck every bit of possible value from business development projects, the overall return on those investments improves dramatically and innovation becomes a bona fide engine of organizational renewal. ▢

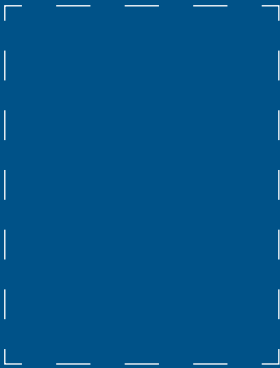
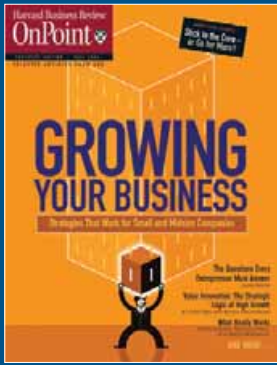
Reprint R0705J

To order, see page 147.



"Say what you want about the guy, but he saves a bundle killing his own lunch every day."

Teresa Burns Parkhurst



A Missed Issue Could Be a Missed Opportunity

Harvard Business Review OnPoint Executive Edition is published quarterly and presents articles from *Harvard Business Review* on a common theme. The articles include full-text *Harvard Business Review* articles plus a summary of key ideas and company examples to help busy managers quickly absorb and apply the concepts. Each OnPoint enhanced article also includes an annotated bibliography.

ORDER BACK ISSUES TODAY
www.onpointhbr.org

Harvard Business Review OnPoint Executive Edition is published quarterly and available only at select newsstands and on our website. It is not available by subscription.



WWW.ONPOINTHBR.ORG

Letters to the Editor

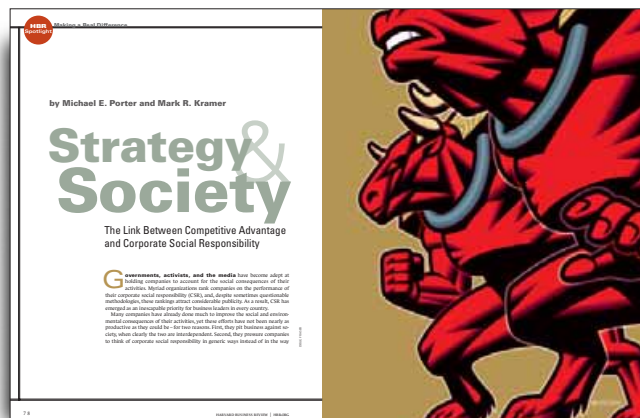
Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility

In “Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility” (December 2006), Michael E. Porter and Mark R. Kramer make the important point that, for maximum effect and long-term profitability, corporate social responsibility (CSR) programs and policies should be aligned with an organization’s core business strategy. A cogent

Organizations are often called upon to “do the right thing” even when no payoff or return on investment is in sight. For example, when Johnson & Johnson went beyond the recommendation of the Food and Drug Administration and made its well-documented decision to temporarily remove all Tylenol products from retail shelves across the United States, many thought that the brand was doomed. The costs of the decision were enormous, but then-CEO James Burke and the rest of the company’s management believed it was the right thing to do. They certainly had no assurance that their decision would result in increased profits in the long run.

Similarly, when Merck could find no government agency or foundation to finance the development of Mectizan, its cure for river blindness, executives like Roy Vagelos (Merck’s CEO at the time) decided that the company itself should bear the heavy development costs and, ultimately, the distribution costs. There was no chance that an enhanced reputation would enable Merck to recoup those expenses in any foreseeable time frame. It was simply inconceivable *not* to move forward with a drug that would bring extraordinary benefit to the world’s poorest peoples.

To cite another example, Peter Haas and the rest of Levi Strauss’s management team faced a dilemma when they learned that one of their important Bangladeshi suppliers was employing young girls to sew its denim apparel. Child labor was strictly against the



argument can be made, as Porter and Kramer suggest, that companies may target philanthropic contributions to improve their profitability. But to equate corporate social responsibility with long-term profitability – that is, to assume that doing good will result in doing well – or to insist that CSR programs must result in some sort of demonstrable return on investment for an organization is dangerous and flawed thinking.

We welcome letters from all readers wishing to comment on articles in this issue. Early responses have the best chance of being published. Please be concise and include your title, company affiliation, location, and phone number. E-mail us at hbr_letters@hbsp.harvard.edu; send faxes to 617-783-7493; or write to The Editor, Harvard Business Review, 60 Harvard Way, Boston, MA 02163. HBR reserves the right to solicit and edit letters and to republish letters as reprints.

company's stated policies, yet if Levi Strauss abruptly ended its contract with the supplier, the girls and their families would undergo additional hardship. So the company arranged for the girls to work shorter hours and to continue their schooling at the same time, financing the solution out of its own pocket. Levi Strauss never made any attempt to publicize this humanitarian effort to heighten its reputation and increase sales.

Doing business in the global environment of the twenty-first century is complex. It should come as no surprise that a corporation's social responsibilities to a multitude of international stakeholders have grown equally complex. The corporation is still at heart a wealth-producing instrument, but it is called upon to be much more. No longer can its sole *raison d'être* be the maximization of shareholder wealth; that time is long past. The global society now expects a corporation to serve a wide array of stakeholders, among whom there is often considerable conflict. This means today's executive must exercise some restraint in reducing costs, pushing up sales and profits, opening new markets, and, yes, bargaining for personal compensation plans. Restraint isn't a characteristic often associated with the hard-driving manager, nor is it taught in our business schools.

D. Kirk Davidson

*Professor of Corporate Social Responsibility and Marketing
Mount St. Mary's University
Emmitsburg, Maryland*

Porter and Kramer respond: We agree that companies need to act as good corporate citizens, "doing the right thing" by mitigating harms and supporting local organizations even when there is no immediate profit to be gained. We call this responsive CSR in our article.

However, we stress that a far greater opportunity for both society and for companies is to find the points where social needs and long-term business needs intersect. Through pursuing such opportunities for shared value, which will differ for each company, business can

have the greatest beneficial impact on society while justifying the ongoing use of resources. It is telling that in D. Kirk Davidson's letter, the social impacts in all three cases were tightly linked to the company's business and essential to the company's enduring position with its customers, channels, and suppliers.

"Doing the right thing" sounds laudable, but it does not help companies determine which of society's many problems they should address. Instead of abandoning the pursuit of economic value, managers need to understand economic value creation in a broader context.

All Eyes on You

In "All Eyes on You" (the Letter from the Editor in the January 2007 issue), Thomas A. Stewart quotes from a heroic speech delivered by Queen Elizabeth I before the arrival of the Spanish Armada. If I remember my history correctly, once the battle was won, the queen would not allow her sailors off their ships, supposedly so they would not have to be paid. The majority got sick or starved to death.

Perhaps citing Sir Francis Drake or Lord Howard would have been a better choice. They were the actual leaders of the fleet and, as I understand it, tried to pay their men and get them released using their own funds.

Above all, a leader must speak the truth, inspire trust, and back up her words with actions; otherwise, it would be better if she said nothing at all. It may be cliché, but once your people lose trust in you, it is extremely difficult, if not impossible, to regain it.

Jeff Werrick

*KRILL (Engineering)
Boeing IRC
Everett, Washington*

**Special Issue:
The Tests of a Leader**

The HBR special issue "The Tests of a Leader" (January 2007) offered articles from outstanding authors who approached this vital topic from many

Rotman
a new way to think

**"If you don't
get the
magazine
from the
Rotman School
of Management,
aptly called
Rotman,
you're making
a mistake."**

— **Bruce Nussbaum**,
Assistant Managing Editor,
BusinessWeek
(online blog, Sept. 27, 2006)

Subscribe to Rotman Magazine today:

www.rotman.utoronto.ca/subscribe

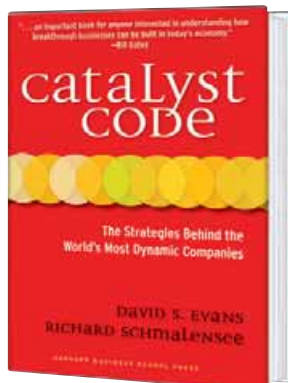
One Year (3 issues): \$95 us

Two Years (6 issues): \$135 us



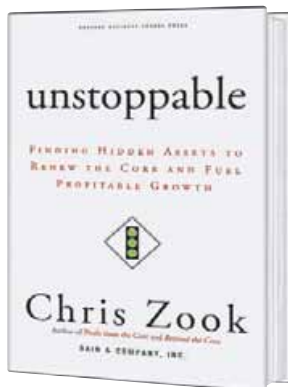
Joseph L. Rotman School of Management
University of Toronto

Start Something Big



"An important book for anyone interested in understanding how breakthrough businesses can be built in today's economy."

Bill Gates



"Unstoppable lets you move the theory right from the pages and into practical use."

Robert Salerno, President and CEO,
Avis Budget Group, Inc.



"Provides insights on what the customer is really demanding."

Andrew Gould, Chairman and CEO,
Schlumberger Limited

Available wherever books are sold

different points of view. Nevertheless, the word "leadership" continues to elude definition. Articles that use titles like chief, boss, manager, leader, executive, general manager, and CEO interchangeably give rise to questions about what these names represent more than they provide answers: Do the authors mean managers, leaders, or both? For example, in "How Leaders Create and Use Networks," Herminia Ibarra and Mark Hunter say that "the ability to figure out where to go and to enlist the people and groups necessary to get there" is what differentiates a leader from a manager. But isn't that a basic requirement for an average manager, too?

A good manager has to do or initiate a lot to be recognized as a real leader, while a bad manager will be replaced sooner or later. But how do we detect a good or a bad leader? Do bad leaders even exist, or are they simply not leaders at all?

Klaus Kuchen

*Regional Board Member
Business Development Director for
Central and South America
Grünenthal
Quito, Ecuador*

How Many Women Do Boards Need?

In "How Many Women Do Boards Need?" (Forethought, December 2006), Alison M. Konrad and Vicki W. Kramer offer data and conclusions that differ significantly from research about and interviews with women who actually serve on public corporate boards of directors. Their findings also run counter to the impressive credentials of first women on boards listed by NewsOnWomen.com, a Web site that gathers press releases from top corporations worldwide announcing promotions of women to senior management positions and to boards of directors in business, technology, science, education, the arts, and philanthropy.

Instead, the authors present anecdotal quotes from select anonymous women and men. This research trivializes the complex issues facing both

male and female corporate governance leaders. If we were to believe their conclusions, then we would have to accept the following: The first woman on any board will be ignored, intimidated, and dismissed as ineffective, shy, and incapable of doing the job. The authors seem to suggest that all women added to boards of corporate directors will bring a woman's agenda to the table. And only girl gangs of three or more women dare serve on corporate boards in order to make magic happen. This does not describe any of the women I've met or interviewed who serve on boards.

No doubt, if one were to ask any man or woman, "Did you ever, in your career, have questions or concerns about whether you were getting your message across?" it is likely that 100% would recall some hesitation somewhere. But to build a research study on queries like this would be akin to building a divorce case around the question "When did you stop beating your wife?"

I am surprised to see this article in HBR, especially given its history of publishing high-quality research on boards and governance by the likes of Jay Lorsch, David Nadler, Jeffrey Sonnenfeld, Cynthia Montgomery, and Rhonda Kaufman. I'm curious about how it might "advance the theory and practice of management." I would also like to know why editors and journalists repeatedly choose to publish dominantly negative material when the subject concerns women in business or leadership.

Elizabeth Ghaffari

*Founder
Champion Boards, a service of
Technology Place
Santa Monica, California*

Konrad and Kramer respond: We share Elizabeth Ghaffari's concern regarding negative material about women in business. Our article emphasized women directors' positive contributions to boards and the importance of increasing the number of women on individual boards in order to take full advantage of those contributions.



**HARVARD
BUSINESS
SCHOOL
PRESS**

www.HBSPress.org

Ghaffari may have misread or misunderstood what we wrote. The phrases “a woman’s agenda,” “girl gangs,” and “make magic happen” do not appear in our article or in the complete study. Rather, we argue that many more qualified women are available than are tapped for board service, and that nominating committees need to seek them out. A majority of the study participants reported that a lone woman has to work hard to be heard and is “often isolated and marginalized” – that having two women helps, but that having three provides a critical mass where women’s contributions are more likely to be fully realized. We also have received many responses to our work confirming that three women working together often make a difference, not only on boards but in other venues as well.

Space constraints limited what we could say, so we urge Ghaffari to read the full report. It was read and approved by the standing publication review committee at the highly regarded Wellesley Centers for Women, in Massachusetts, where the research was housed. In it she will find a thorough explanation of our careful methodology and of the necessity of promising anonymity to the high-profile *Fortune* 1,000 board participants in order to secure candid responses. She can also examine the lengthy questionnaire we developed to interview 50 women directors, 12 CEOs, and seven corporate secretaries from *Fortune* 1,000 companies, precisely to avoid the kind of questions she imagines we asked.

Off-Ramp – or Dead End?

Sharman Esarey and Arno Haslberger, the authors of the HBR case study “Off-Ramp – or Dead End” (February 2007), did a terrific job of capturing the difficulties that working mothers face, but the commentators completely missed the point. Their solutions all focused on how Cheryl needed to manage herself, her boss, and her family better. They all assumed that hers was a personal problem, one she could solve if only she were more “strategic,” better at saying no, or just not so darn guilt ridden.

What American corporations need to realize is that *they* are the ones with the problem. A male breadwinner supporting a stay-at-home mom is a fundamentally outdated model. Companies must rethink their approach to achieving work-life balance. Unfortunately, those that do retool the current, onerous approach to the workweek risk placing themselves at a competitive disadvantage.

People were not created to serve the needs of business. Business was created to serve the needs of people. By eliminating overtime exemptions for white collar and salaried workers – thus making 60-hour weeks less alluring – and increasing new parents’ benefits to include up to one year of paid leave, the federal government could help corporations serve some of their most important stakeholders: their employees. Smart companies should be inviting regulation that will help level the playing field and improve employees’ quality of life.

Cindy Lord
Minneapolis

Strategic Humor

I have been a subscriber and avid reader since I became a full-time mediator and arbitrator of employment and commercial disputes. HBR provides excellent coverage of business and management trends that is useful in dispute resolution.

However, if you review the cartoons from the past several years, I think you will be surprised and disturbed that HBR has not changed its graphic imagery to reflect the efforts that have been made to promote diversity in the workplace. Its cartoons and graphics almost exclusively depict white male executives, rarely showing females, minorities, or disabled people in management roles. While they satirize white male managers, they reinforce the stereotypical assumption that females, minorities, and disabled people do not usually hold positions of authority.

Ruth D. Raisfeld
President

Ruth D. Raisfeld, P.C.
Alternative Dispute Resolution Services
Scarsdale, New York

Rotman

“Managers who want to ‘get’ the new innovation paradigm should check out [Rotman’s] MBA programs.”

(BusinessWeek online, March 7, 2005)

— Bruce Nussbaum,
Assistant Managing Editor,
BusinessWeek

Find out what thought leaders already know.

Order your free copy of
The Best of Rotman Magazine, Volume 2



www.rotman.utoronto.ca/best
E: best@rotman.utoronto.ca
T: 416-946-0103



Joseph L. Rotman School of Management
University of Toronto

Executive Summaries

MAY 2007



“One conclusion, in particular, is striking: Chances are high that executives will find themselves out the door.”
—page 62

SELF-MANAGEMENT

COVER STORY

62 | Surviving Your New CEO

Kevin P. Coyne and Edward J. Coyne, Sr.

Almost 50% of the largest American firms will have a new CEO within the next four years; your company could very well be next. Senior executives know that a CEO transition means they're in for a round of firings, organizational reshuffles, and other unwelcome career changes. When your career suddenly depends on the views of a person you may not know, how worried should you be?

According to the authors—very. They investigated the 2002–2004 CEO turnover rates of the top 1,000 U.S. companies and interviewed more than a dozen CEOs, each of whom had taken over at least one very large organization. Their study reveals that when a new CEO takes charge, remaining top managers are more likely than not to be shown the door. Those who leave often land in a lower position at a new company, work in a much smaller firm, or retire altogether. The news is not all grim, however. The interviewees offer some pointers on how to create a good impression and maximize your chances of survival and success under the new regime.

Some of that advice may surprise you. One CEO pointed out, for instance, that “managers do not realize how much the CEO is looking for teammates on day one. I am amazed at how few people come through the door and say, ‘I want to help. I may not be perfect, but I buy into your vision.’” Other recommendations are more intuitive, such as learning the new CEO's working style, understanding her agenda, and helping her look good in her new position by achieving positive operating results—and soon.

Along with the inevitable stresses, the authors point out, CEO transitions can provide opportunities. Whether you reinvigorate your career within your company or find fulfillment elsewhere, the key lies in deciding what you want to do—and then doing it right.

Reprint R0705C; HBR Article Collection
“Managing Up, 2nd Edition” 2099

FORETHOUGHT

22 | Viral Marketing for the Real

World By combining viral-marketing tools with mass marketing, you can extend your reach at minimal cost. **Reprint F0705A**

Why Employees Are Afraid to Speak

In a word—self-preservation. And they're just as afraid to share innovative ideas as to blow the whistle. **Reprint F0705B**

Service with a Very Big Smile

New research confirms that the bigger the employees' smiles, the happier the customers. **Reprint F0705C**

So You Think You Understand

Revenues The sophisticated technologies used to understand costs don't illuminate revenue sources well. For that you need a whole new breed of accountant. **Reprint F0705D**

How Risky Is Overtime, Really?

Not all that much, empirical data from two medical researchers suggest. **Reprint F0705E**

A Larger Language for Business

Poet David Whyte talks about how poetry begets courageous conversation and, in turn, better leadership. **Reprint F0705F**

Higher Net Price—Or Bust

When it comes to judging the success of innovations, the important measure to track isn't sales; it's net prices. **Reprint F0705G**

Getting Unusual Suspects to Solve

R&D Puzzles Your problem solvers could be not only out in the wider world but also in the wide reaches of your own organization. **Reprint F0705H**

Reviews

Featuring *The Strategy Paradox: Why Committing to Success Leads to Failure (and What to Do About It)*, by Michael E. Raynor.

HBR CASE STUDY

37 | The Dark Side of Customer Analytics

Thomas H. Davenport and Jeanne G. Harris

Health insurer IFA and grocery chain ShopSense have formed an intriguing partnership, but it threatens to test customers' tolerance for sharing personal information.

For years, IFA's regional manager for West Coast operations, Laura Brickman, had been championing the use of customer analytics—drawing conclusions about consumer behaviors based on patterns found in collected data. She came away from a meeting with the grocer's analytics chief, Steve Worthington, convinced that ShopSense's customer loyalty card data could be meaningful. In a pilot test, Laura bought ten years' worth of data from the grocer and found some compelling correlations between purchases of unhealthy products and medical claims. Now she has to sell her company's senior team on buying more information.

Her bosses have some concerns, however. If IFA came up with proprietary health findings, would the company have to share what it learned?

Meanwhile, Steve is busy trying to work out details of the sale with executives at ShopSense. Many have expressed support, but COO Alan Atkins isn't so sure: If customers found out that the store was selling their data, they might stop using their cards, and the company would lose access to vital information. Though CEO Donna Greer agrees, she knows that if things go well, it could mean easy money.

How can the two companies use the customer data responsibly? Commenting on this fictional case study are George L. Jones, the CEO of Borders Group; Katherine N. Lemon, an associate professor of marketing at Boston College; David Norton, the senior vice president of relationship marketing for Harrah's Entertainment; and Michael B. McCallister, the president and CEO of Humana.

Reprint R0705A

Case only R0705X

Commentary only R0705Z

51 | Back in Fashion: How We're Reviving a British Icon

Stuart Rose

Back in 1998, Marks & Spencer was the first British retailer to reach a profit of £1 billion. Just a few years later, profits were down to £145 million, and the company's share price stood at two-thirds of its previous high. The problem, says CEO Stuart Rose, was that M&S lost sight of what had made it great for more than a century.

In this first-person account, Rose explains that he was hired in the spring of 2004 to turn the company around—just in time to stave off retail investor Philip Green's hostile takeover attempt. He spent his first six weeks convincing reporters, analysts, and investors that he was the one to lead Marks & Spencer back to prosperity. Then, after Green withdrew his bid, Rose put his plans for M&S to work.

He knew that three things needed to be done right away: improve the product, improve the stores, and improve the service. One of his first and most important changes was to tighten the reins on inventory. When Rose arrived at M&S, assistant buyers were spending more than £300 million of the company's money without oversight. Management now gets weekly inventory updates.

With a keen eye on fundamentals like stock control, Rose has tried to return Marks & Spencer to the levels of profitability it achieved before its sharp decline. Although there is more to do, the company is back on track. In November 2006, M&S posted half-year profits of £405.1 million—up 32.2% from the previous fiscal year. Rose attributes the turnaround almost entirely to a renewed focus on core values.

Now, with signs of health in the business, he is thinking about where to take it over the next four or five years, so M&S doesn't get stuck as the largest of the small retailers and the smallest of the large retailers in the United Kingdom.

Reprint R0705B

HARVARD BUSINESS SCHOOL

EXECUTIVE EDUCATION



SENIOR EXECUTIVE SEMINAR FOR RETAILERS AND SUPPLIERS

JUNE 24–26, 2007

LEADING SCIENCE-BASED ENTERPRISES

JUNE 26–29, 2007

FINANCE FOR SENIOR EXECUTIVES

JULY 8–14, 2007

LEADING PRODUCT DEVELOPMENT

JULY 9–13, 2007

DRIVING CORPORATE PERFORMANCE: ALIGNING SCORECARDS, SYSTEMS, AND STRATEGY

JULY 15–20, 2007

STRATEGIC AGILITY: LEADING FLEXIBLE ORGANIZATIONS

JULY 15–20, 2007

DELIVERING INFORMATION SERVICES

JULY 22–28, 2007

CHANGING THE GAME: NEGOTIATION AND COMPETITIVE DECISION MAKING

AUGUST 12–17, 2007

For more information, visit
www.exed.hbs.edu/pgm/uphbr/

ORGANIZATION & CULTURE

72 | Inner Work Life: Understanding the Subtext of Business Performance

Teresa M. Amabile and Steven J. Kramer

Anyone in management knows that employees have their good days and their bad days—and that, for the most part, the reasons for their ups and downs are unknown. Most managers simply shrug their shoulders at this fact of work life. But does it matter, in terms of performance, if people have more good days than bad days?

Teresa Amabile and Steven Kramer's new stream of research, based on more than 12,000 diary entries logged by knowledge workers over three years, reveals the dramatic impact of employees' *inner work lives*—their perceptions, emotions, and motivation levels—on several dimensions of performance. People perform better when their workday experiences include more positive emotions, stronger intrinsic motivation (passion for the work), and more favorable perceptions of their work, their team, their leaders, and their organization. What the authors also found was that managers' behavior dramatically affects the tenor of employees' inner work lives.

So what makes a difference to inner work life? When the authors compared the study participants' best days to their worst days, they found that the single most important differentiator was their sense of being able to make progress in their work. The authors also observed interpersonal events working in tandem with progress events. Praise without real work progress, or at least solid efforts toward progress, had little positive impact on people's inner work lives and could even arouse cynicism. On the other hand, good work progress without any recognition—or, worse, with criticism about trivial issues—could engender anger and sadness. Far and away, the best boosts to inner work life were episodes in which people knew they had done good work and their managers appropriately recognized that work.

Reprint R0705D; HBR Article Collection
"Build a Motivated Workforce, 2nd
Edition" 2102

STRATEGY & COMPETITION

84 | Strategies to Crack Well- Guarded Markets

David J. Bryce and Jeffrey H. Dyer

How can companies break into attractive markets, where incumbents erect many barriers to entry? To answer this question, the authors studied organizations that successfully entered the most profitable industries in the United States between 1990 and 2000. When they dissected the strategies that worked best, one common theme stood out: indirect assault. Smart newcomers don't duplicate existing business models, compete for crowded distribution channels, or go after mainstream customers right away. Instead, they attack the enemy at its weakest points; then gain competitive advantage; and later, if doing so meets their objectives, go after its strongholds.

Recent battles in the soft drink industry—where brands, bottling and distribution capabilities, and shelf space are incumbents' main advantages—are a case in point. When Virgin Drinks entered the U.S. cola market in 1998, it advertised heavily and immediately tried to get into the retail outlets that stock the leading brands. Virgin has never garnered more than a 1% share of the market. Red Bull, by contrast, came on the scene in 1997 with a niche product: a carbonated energy drink. The company started by selling the drink at bars and nightclubs. After gaining a loyal following through these outlets, Red Bull elbowed its way into the corner store. In 2005 it enjoyed a 65% share of the \$650 million energy drink market.

Successful entrants use three basic approaches in their indirect attacks. They leverage their existing assets and resources, reconfigure their value chains, and create niches. These approaches may appear to be simple, but their magic lies in their combination. By mixing and matching them, Bryce and Dyer say, enterprises can defy half a century of economic logic and make money entering highly profitable industries. The authors use Skype, Costco, Skechers, and many other companies to illustrate their argument.

Reprint R0705E

98 | Silo Busting: How to Execute on the Promise of Customer Focus

Ranjay Gulati

For many senior executives, shifting from selling products to selling solutions—packages of products and services—is a priority in today's increasingly commoditized markets. Companies, however, aren't always structured to make that shift. Knowledge and expertise often reside in silos, and many companies have trouble harnessing their resources across those boundaries in a way that customers value and are willing to pay for.

Some companies—like GE Healthcare, Best Buy, and commercial real estate provider Jones Lang LaSalle (JLL)—have restructured themselves around customer needs to deliver true solutions. They did so by engaging in four sets of activities:

Coordination. To deliver customer-focused solutions, three things must occur easily across boundaries: information sharing, division of labor, and decision making. Sometimes this involves replacing traditional silos with customer-focused ones, but more often it entails transcending existing boundaries. JLL has experimented with both approaches.

Cooperation. Customer-centric companies, such as Cisco Systems, develop metrics for customer satisfaction and incentives that reward customer-focused cooperation. Most also shake up the power structure so that people who are closest to customers have the authority to act on their behalf.

Capability. Delivering customer-focused solutions requires some employees to be generalists instead of specialists. They need experience with more than one product or service, a deep knowledge of customer needs, and the ability to traverse internal boundaries.

Connection. By combining their offerings with those of a partner, companies can cut costs even as they create higher-value solutions, as Starbucks has found through its diverse partnerships.

To stand out in a commoditized market, companies must understand what customers value. Ultimately, some customers may be better off purchasing products and services piecemeal.

Reprint R0705F



MIT SLOAN EXECUTIVE EDUCATION.

Because All The Easy Problems Have Already Been Solved.

In a world of growing complexity, the traditional approaches to management that have shaped executive leadership for decades are no longer sufficient to run the modern organization. At the MIT Sloan School of Management, our programs combine technology, innovation, and leadership to provide senior executives and high-potential managers with the critical skills and practical tools needed to address today's complicated management challenges and lead successful organizations into the future.

Upcoming Programs:

- | | |
|-----------|--|
| Jun 3–8 | Leading Change in Complex Organizations |
| Jun 10–15 | Corporate Strategy |
| Jun 18–22 | Business Dynamics: MIT's Approach to Diagnosing and Solving Complex Business Problems |
| Sep 16–21 | Driving Strategic Innovation: Achieving Breakthrough Performance Throughout the Value Chain |
| Nov 11–16 | Managing the Extended Supply Chain: Beyond Productivity and Efficiency |



<http://mitsloan.mit.edu/hbr>

Phone: +1 617.253.7166

Email: sloanexeced@mit.edu

110 | Even Commodities Have Customers

François M. Jacques

When François Jacques became head of marketing at Lafarge's cement division in late 2001, old-timers told him that there were only two types of customers: those who liked golf and those who liked fishing. Welcome to the front lines of your typical cement company, a hardscrabble world peopled by grizzled salesmen whose pitches are about making friends rather than demonstrating that their products are better than the competition's.

It isn't easy to establish a marketing function in a company that doesn't think it needs one. From the start, Jacques tackled the challenge on a number of fronts. First, he formed a three-person steering committee with both his strongest ally and his most vociferous foe in the executive ranks. Then he set right to work applying marketing's most basic and powerful tools—segmentation and pricing strategy—to four carefully chosen pilot projects. To make the value of those efforts quickly apparent, he measured their effectiveness with readily understood metrics. He shared the ongoing results as widely as possible by establishing regional networks of marketing and sales executives. He wove marketing into Lafarge's mainstream management processes by becoming a fixture at the company's strategic-planning, performance, and budgeting discussions.

Step by step, over the next four years, Jacques and his team of first temporary, and then permanent, marketers fundamentally transformed Lafarge's commodity mind-set. Segmenting customers allowed people to see that they were selling to different groups that required different products, which in many cases could be sold for higher-than-commodity prices. Customer satisfaction surveys led them to improve supply chain execution and, ultimately, to change what they sold, so that their offerings were suited to a range of customer requirements, increasing value both for them and for the division.

Many firms have a marketing function in name only. These lessons can serve as a model for such companies looking to escape the commodity trap.

Reprint R0705G

121 | Picking Winners A Conversation with MacArthur Fellows Program Director Daniel J. Socolow

In the business world, "creativity" has become the latest buzzword. How to attract, nurture, and direct the extraordinarily talented people who will come up with the next Lipitor, Sony Walkman, or iPod is an enduring topic among businesspeople. As the director of the MacArthur Fellows Program, Daniel J. Socolow has considerable experience with the process of rooting out creativity. In this conversation with HBR senior editor Diane Coutu, he describes how recipients of the "genius grant"—half a million dollars with no strings attached—are chosen.

As significant as the money is, the recognition that comes with a fellowship may be more so. MacArthur grants provide powerful validation of the fellows' work, Socolow says, and that validation opens doors for people, whatever the field. Although the program keeps a lookout for entrepreneurs who are on the brink of major new advances, he believes that the market does a good job of rewarding the best ideas in business.

Replicating the MacArthur model in a company would entail giving some employees unlimited time and lots of money to follow their own inclinations—not very feasible in most contexts. Nevertheless, the program has learned a lesson that may be valuable for business: The kind of creativity that leads to important breakthroughs is extremely hard to find. And, says Socolow, exceptionally creative people aren't always the obvious suspects, who may simply be good at promoting themselves: "Listen to others and look in the least likely places...Extend your networks and try to get information from as many people as possible, just as we do."

Reprint R0705H

128 | The Value Captor's Process: Getting the Most out of Your New Business Ventures

Rita Gunther McGrath and Thomas Keil

The high failure rate among new business ventures is usually chalked up to the fundamental uncertainty of the process. In actuality, say McGrath and Keil, flawed ways of assessing and managing ventures may account for the disappointing amount of value they generate. Instead of taking the go/no-go approach, whereby a project either advances toward launch or is killed, decision makers should consider a range of alternatives: recycling the venture by aiming it at a new target market; spinning it off to other owners or a joint venture; spinning it in to an established business unit; or salvaging useful elements such as technologies, capabilities, knowledge, and patents.

Firms that excel in value extraction—the "value captors" whose practices and mind-set this article explores—have created formal processes to systematically mine successes, failures, and everything in between. They know that a venture should be treated like a scientific experiment, in which learning plays a critical role. They are ready to seize new opportunities if a venture falters on its original course. They foster networks to promote cooperation and collaboration between established business leaders and venture teams and involve people from throughout the company in the venture review process. They don't allow financial criteria to dominate the reviews, and they recognize that the best people to launch a business may not be the ones who developed the idea. If your innovation pipeline is dry, your promising projects are being strangled for lack of a speedy payback, or someone else has made a fabulous business out of a slightly altered idea that you abandoned, consider the value captor's path.

Reprint R0705J

ACCESS TO HBR ONLINE

Subscribers can access the online version of HBR at www.hbr.org. First-time visitors will need to verify subscription information, such as their subscriber ID number, which can be found through the “look up” function.

Nonsubscribers can also access select articles at www.hbr.org.

SUBSCRIPTION SERVICES

Visit www.hbr.org to subscribe, renew, or manage your subscription.

U.S. AND CANADA

800-274-3214 | 813-354-3467 fax
subsvcs@hbr.customersvc.com
www.hbrcustomerservice.com
Harvard Business Review
P.O. Box 62270
Tampa, FL 33662-2701

OVERSEAS AND MEXICO

31-20-4874465 | 31-20-4874412 fax
hbr.intl@customersvc.com
www.hbr.org/customerservice
Harvard Business Review
P.O. Box 20501
1001 NM Amsterdam
The Netherlands

RATES PER YEAR

U.S., \$119 | Canada, U.S.\$139
International, U.S.\$165 | Mexico, U.S.\$139

**HARVARD BUSINESS REVIEW
ARTICLE REPRINTS**

To purchase *Harvard Business Review* article reprints or to obtain permission to copy, quote, or translate them, contact our customer service team. Reprint numbers and article collection information appear at the ends of articles and executive summaries. Reprints are available in hard copy, as electronic downloads with permission to print, and in customized versions.

FOR INFORMATION OR TO ORDER

Customer Service Department
Harvard Business School Publishing
617-783-7500
U.S. and Canada: 800-988-0886
(8 AM – 6 PM ET weekdays)
www.hbrreprints.org

CUSTOM AND QUANTITY ORDERS

For quantity estimates or quotes on customized *Harvard Business Review* article reprints, contact Rich Gravelin:
617-783-7626 | rgravelin@hbsp.harvard.edu

LIBRARY ACCESS

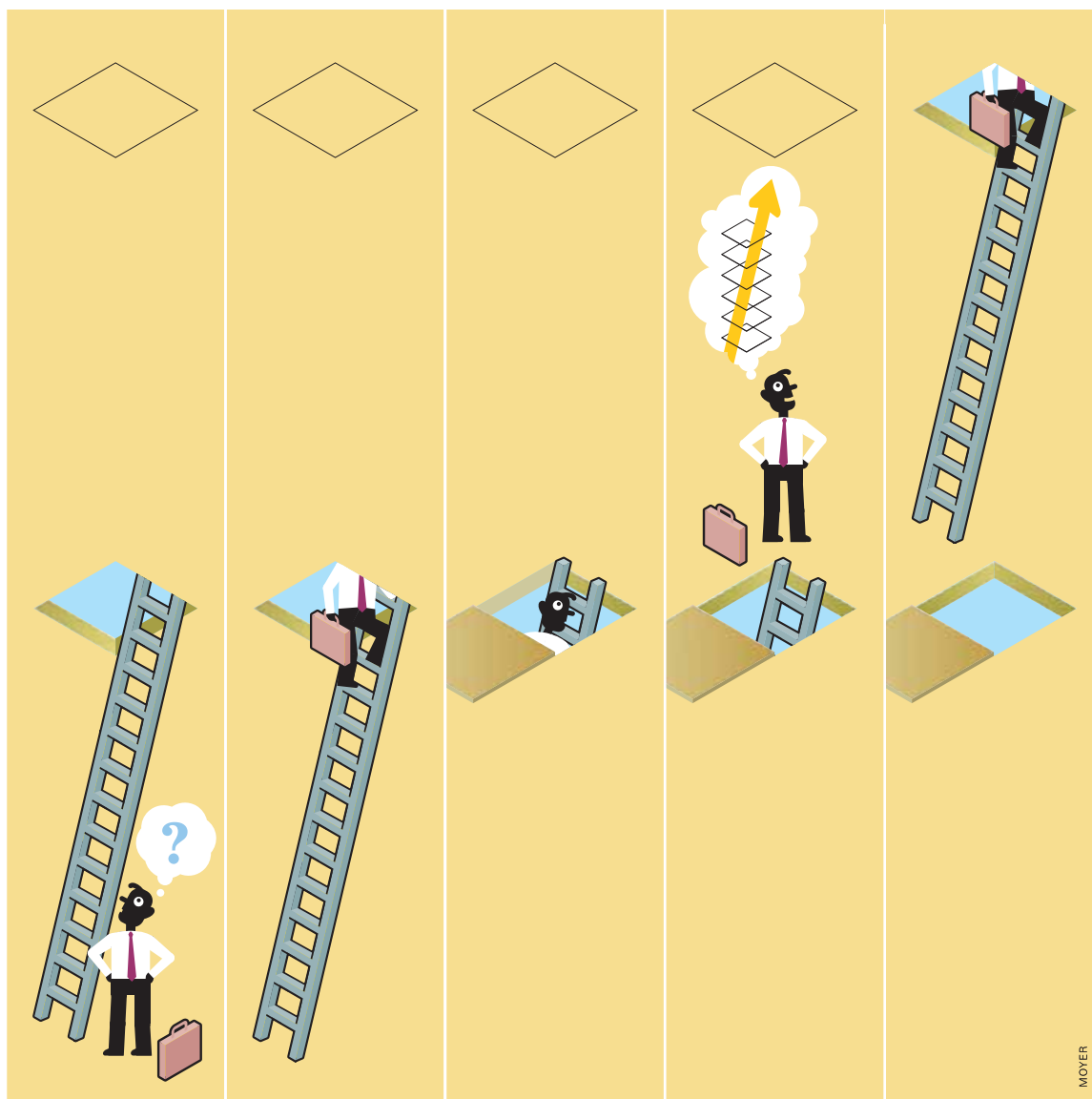
Libraries offer online access to current and back issues of *Harvard Business Review* through EBSCO host databases.

POSTMASTER:

Send domestic address changes, orders, and inquiries to: *Harvard Business Review*, Subscription Service, P.O. Box 62270, Tampa, FL 33662. GST Registration No. 124738345. Periodical postage paid at Boston, Massachusetts, and additional mailing offices. Printed in the U.S.A. *Harvard Business Review* (ISSN 0017-8012; USPS 0236-520), published monthly (with a combined July–August issue) for professional managers, is an education program of Harvard Business School, Harvard University; Jay O. Light, dean. Published by Harvard Business School Publishing Corporation, 60 Harvard Way, Boston, MA 02163. Copyright © 2007 Harvard Business School Publishing Corporation. All rights reserved. Volume 85, Number 5



“Up until a few years ago, no one even thought you *could* put a printer in a running shoe.”



MOYER

The Stages of Learning

BECAUSE LEARNING IS A LIFELONG PROCESS, no level of expertise is more than a way station. Successfully addressing one challenge merely creates a foundation for tackling the next.

Of course, not everyone uses that foundation. Learning is based on experience, but experience doesn't guarantee learning. As George Bernard Shaw said, "Men are wise in proportion, not to their experience, but to their capacity for experience." One needs to pay attention to find the lessons.

Formal training can help, but often it is an impediment to learning. As Peter Drucker pointed out in "Managing Oneself" (HBR March–April 1999), "Schools everywhere are organized on the assumption that there is only one right way to learn and that it is the same way for everybody. But to be forced to learn the way a school teaches is sheer hell for students who learn differently."

People who, knowing their own learning style, are able to coax learning out of their experiences will have a leg up over others. After all, no person or organization is forced up the ladder of learning. As W. Edwards Deming wrote, "Learning is not compulsory...neither is survival."

Don Moyer can be reached at dmoyer@thoughtformdesign.com.



Investments and services are offered through Morgan Stanley & Co. Incorporated, member SIPC. © 2007 Morgan Stanley.

Morgan Stanley

WORLD WISE

The windfall. What do you do when wealth suddenly comes your way? Last year Morgan Stanley completed more than \$720 billion of global Mergers and Acquisitions transactions. And, in the process, helped owners and leaders of businesses both large and small deal with the consequences of a sudden increase in personal wealth. Whether you benefit from a merger or the sale of a business, no one is better suited to help you think through your opportunities than a Morgan Stanley Financial Advisor.

Ask a Financial Advisor today.

Visit morganstanley.com/WORLDWISE
or call 866.479.1836